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

Income Limits

The top credit applies only for those with earned income or adjusted gross income (AGI) that is above a specified amount but does not exceed a threshold phaseout amount. For 2010, the phaseout range for all married filers is increased; thus they can have more income without losing the credit. In order to understand the phaseouts, you need to know the following definitions:

- "Earned income amount" is the amount of earned income at or above which (up to the threshold phaseout amount) the maximum credit can be claimed. Earned income does not include any nontaxable benefits (e.g., elective deferral contributions to 401(k) plans and employer-paid educational assistance). Effectively, earned income is the amount reported as wages on an employee's W-2 form or, for self-employed individuals, the amount reported as net earnings from self-employment. For those in the military, earned income can include combat pay if they so elect.
- "Threshold phaseout amount" is the greater of AGI or earned income above which the maximum credit starts to phase out.
- "Completed phaseout amount" is the greater of AGI or earned income at which no credit can be claimed.

Table 1.3 shows the earned income phaseout ranges for the earned income credit in 2010. In most cases, these are higher than the ranges for 2009.

TABLE 1.3 Earned Income Credit Limits

	Number of Qualifying Children			
Item	**One**	**Two or More**	**Three or More**	**None**
Earned income	$ 8,970	$12,590	$12,590	$ 5,980
Threshold phaseout amounts (single, head of household, surviving spouse)	16,450	16,450	16,450	7,480
Completed phaseout amount (single, head of household, surviving spouse)	35,535	40,363	43,352	13,460
Threshold phaseout amounts (married filing jointly)	21,460	21,460	21,460	12,490
Completed threshold amounts (married filing jointly)	40,545	45,373	48,362	18,470

PLANNING

A number of rules for the earned income credit are set to expire at the end of 2010 unless Congress opts to retain some or all of them, including the increased credit amount for those with three or more dependents and the "marriage penalty relief" built into the phaseout amounts.

Due to the complexity of the earned income credit rules, the IRS will compute the earned income credit for you if you ask. First, make sure you're eligible for the credit. Then, simply put "EIC" on the dotted line where the credit amount would be entered. Complete all other parts of the return, but omit the lines that relate to your total payments, overpayment, refund, or amount owed (these can be completed only after the IRS figures your EIC). If you have a qualifying child, also complete Form EIC and attach it to the return.

Unearned Income Limit Increased

The earned income credit cannot be claimed if you have unearned income—from interest, dividends, and other investments—that exceeds a set amount. For 2010, the unearned income limit is $3,100 (the same as in 2009). This limit can be adjusted annually for inflation, but if inflation remains low there may be little or no adjustment for 2011.

Advanced Earned Income Credit

For 2010, the credit can be received on an advanced basis by individuals with at least one qualifying child; there is no advanced payment for someone with no qualifying child. The employer must increase take-home pay to account for the advanced payment of the credit. For 2010, the advanced payment can be as much as $1,830. The advanced earned income credit has been repealed starting in 2011. Congress determined that it had been underutilized and that eliminating it would result in additional revenue to fund other tax breaks.

Child Tax Credit

The tax law provides taxpayers with a credit simply for having a child. You don't have to show that you spent a particular amount of money or anything else other than the fact that you have a qualifying child (a child under age 17 who can be claimed as your dependent) or children. The credit amount is $1,000 per

eligible child (the same as it was in 2009). There is no limit on the number of children for whom this credit can be claimed.

Taxpayers with income above a threshold amount may not claim the credit. The credit begins to phase out for singles with AGI of $75,000 and for married couples filing jointly of $110,000. This AGI threshold has not changed from 2009 and will not be adjusted for inflation in the future.

Refundable Child Tax Credit

At least a portion of the child tax credit may be refundable—paid to you in excess of your tax liability. The refundable amount is 15 percent of earned income from wages or self-employment in excess of a set amount. For 2010, this set amount is $3,000 (the same as it was in 2009).

PLANNING

The current level of the child tax credit is due to sunset at the end of 2010, meaning the credit will be only $500 per eligible child in 2011 unless Congress extends the current break.

Adoption Credit

The tax law rewards by means of a tax credit a parent or parents who adopt a child. Alternatively, a parent may be eligible for an exclusion from income if his or her employer pays such expenses under a company adoption plan. These tax breaks (the credit and the exclusion) are designed to offset to some degree the high cost of adoption, which ranges up to $2,500 for public agency adoptions and can cost $40,000 or more for private agency fees.

All of the qualified costs of adoption can be taken off your tax bill as a credit, up to a set amount. The set amount of the adoption credit increases in 2010 to $13,170 (up from $12,150 in 2009). The credit in 2010 and 2011 is fully refundable, which means you can receive this amount even if it is more than the taxes you owe for the year.

If your employer pays for or reimburses adoption costs under a company's adoption assistance plan in 2010, you can exclude from income up to $13,170. But you can't take a tax credit for the same amount.

With respect to a special-needs child, the credit or exclusion can be claimed without regard to actual expenses; you get it just for making the adoption.

Income Limits

The full credit and exclusion may be claimed only by taxpayers with modified AGI up to $182,520 in 2010 (up from $182,180 in 2009). The credit phases out so that no credit can be claimed once modified AGI exceeds $222,520 in 2010 (up from $222,180 in 2009). The same MAGI limit applies to both singles and joint filers.

PLANNING

When claiming the adoption credit on Form 8839, you cannot file your return electronically; you *must* attach to your paper return:

- For U.S. adoptions, attach a copy of the adoption order or decree.
- For adoptions finalized abroad, include the child's Hague Adoption Certificate, an IH-3 visa, or a foreign adoption decree translated into English. If the child's country of origin is not a party to the Hague Convention, then attach a copy of the translated decree or an IR-2 or IR-3 visa.
- If you adopt a special needs child, also attach the state determination certificate so you can claim the full $13,170, regardless of the adoption costs you paid.

The adoption credit can be indexed for inflation in 2011. Higher credit limits and refundability are set to end on December 31, 2011, unless Congress extends the current rules.

Child and Dependent Care Credit

You may be able to claim a tax credit for costs you incur to care for your child under age 13 or a disabled dependent or spouse of any age so you can work (or attend school). The basic rules for this credit have not changed from last year. The maximum amount of qualified expenses you can take into account in figuring the credit is $3,000 for one qualifying dependent ($6,000 for two or more qualifying dependents). The credit rate depends on your AGI. For those with AGI over $43,000, the credit rate is 20 percent, so your top credit amount is $600 for one dependent and $1,200 for two or more dependents.

PLANNING

There have been proposals in Congress to increase the amount of this credit, so watch for changes. However, if Congress takes no action, then the amount of

eligible expenses taken into account for purposes of the credit, along with other favorable rules, will expire at the end of 2010. For example, instead of $3,000 of expenses taken into account for one dependent, only $2,400 could be allowed in 2011, reducing the minimum credit from $600 ($3,000 × 20 percent) to $480 ($2,400 × 20 percent).

Kiddie Tax

The government was concerned that families were putting investments in a child's name so that income received by the child would be taxed at rates lower than those if the parent had kept the investments and received the income. Congress created a so-called kiddie tax on unearned income over a set amount. It is not a separate tax. Rather, the child is taxed on unearned income over a set amount at the parent's highest marginal tax rate.

Example

A child subject to the kiddie tax has $3,000 of investment income above the threshold. The child is in the 10 percent bracket; the parents are in the 28 percent bracket. Under the kiddie tax, the child pays $840 on this income (28 percent of $3,000).

Who Is Subject to the Kiddie Tax?

For 2010, a "child" for purposes of the kiddie tax means a child who is age 18 or under at the end of the year if he or she does not have earned income exceeding half the child's support for the year. It also includes a child who is 19 through 23 as of December 31 if the child is a full-time student during the year and does not have earned income exceeding half of his or her support for the year. The definition of a child for kiddie tax purposes has *not* changed from 2009.

A child who is born on January 1 is treated as having his or her birthday on December 31 of the previous year. Thus, a girl born on January 1, 1987, who has her 24th birthday on January 1, 2011, is treated as being born on December 31, 1986, so that she is considered to be 23 years old in 2010.

If a child otherwise subject to the kiddie tax because of age and income is orphaned, then the kiddie tax does not apply. Also, it does not apply if the child is married and files a joint return with his or her spouse.

Threshold Amounts

The kiddie tax applies only if the child has unearned income above a threshold amount. For 2010, the threshold is $1,900, which is unchanged from 2009. Unearned income includes interest on bank savings accounts, stock dividends, capital gain distributions from mutual funds, and capital gains from the sale of property.

While the 2010 threshold amount for the kiddie tax is $1,900, the first $950 of unearned income is tax free to the child and the next $950 is taxed to the child at a rate of 10 percent. Only unearned income over $1,900 is taxed to the child at the parent's rate.

PLANNING

If a child has unearned income over $950 for 2010, a tax return must be filed for the child; the parent usually is the person to do this and signs the return as follows: "By [your signature], parent [or guardian] for minor child."

However, a parent can elect to include the child's unearned income on the parent's own return and avoid the need to file a separate return for the child. In order to make this election and report the child's income on the parent's return, all of the following conditions must be met:

- The child's only income for the year is from interest and dividends (including capital gain distributions from mutual funds and Alaska Permanent Fund dividends).
- This unearned income totals more than $950 but not more than $9,500.
- No estimated taxes were paid on behalf of the child for the year and there was no tax overpayment from the previous year applied to estimated taxes for the year.
- The child is not subject to backup withholding.

Just because you are eligible to report your child's unearned income on your return does not mean it's a good idea to do so. Adding the child's unearned income to your own will increase your adjusted gross income by the amount of the child's unearned income, which can limit or prevent you from qualifying for many tax breaks. The only two instances in which it may be helpful are:

1. When you want to boost your investment interest deduction by adding your child's investment income to your own so you can claim a larger deduction for investment interest.
2. When you want to increase AGI/MAGI so you can claim a larger charitable contribution deduction.

A child's earnings from a job or self-employment are not subject to the kiddie tax. Parents who have businesses may employ their children, enabling the family to reap several tax benefits:

- Wages for a child up to $5,700 are tax free in 2010.
- The child can contribute his or her earnings (up to $5,000) to an IRA or Roth IRA.
- The parent can deduct wages paid to the child as a business expense.
- If the parent is self-employed and the child is under the age of 18, then wages paid by the parent are exempt from payroll taxes (FICA [Federal Insurance Contributions Act] and FUTA [Federal Unemployment Tax Act]).

Additional Medicare Tax

Starting in 2013, there is a new 3.8 percent additional Medicare tax on investment income of individuals with MAGI of more than $200,000, or joint filers with MAGI of more than $250,000. Currently, it is not clear whether this additional Medicare tax will affect children subject to the kiddie tax if their parents' MAGI tops the threshold for the additional Medicare tax.

PLANNING

Watch for developments concerning the application of the additional Medicare tax to the kiddie tax.

Tax on Household Employees

If you engage workers in your home who are not in their own businesses or are not employees of a company, such as an agency, then you may be obligated to pay employment taxes for your household employees. Employment tax on household employees is referred to as the "nanny tax." The nanny tax imposed

on wages paid to household employees isn't limited to nannies. It can apply to housekeepers, au pairs, cooks, drivers, gardeners, and anyone else who works for you or your family full-time or part-time. The nanny tax comprises Social Security and Medicare (FICA) taxes and federal unemployment (FUTA) tax.

FICA is required for a household employee only if cash wages exceed a threshold amount. For 2010, the threshold amount is $1,700, the same as it was in 2009. Once wages exceed the threshold, then *all* wages for the year are subject to FICA; there is no exemption for the first $1,700. FICA taxes are explained earlier in this chapter.

FUTA taxes apply if you pay cash wages of $1,000 or more during any calendar quarter in 2009 or 2010. The FUTA rate is 6.2 percent of the first $7,000 of cash wages; there is a credit of 5.4 percent, so the actual rate is 0.8 percent (the top FUTA payment per worker usually is $56). However, rates for residents in some states may be higher in 2010 and 2011 because state unemployment funds have not repaid funds borrowed from the federal government; check with your state unemployment office (find links to your state's tax department at www.business.gov/manage/taxes/state.html).

PLANNING

Certain workers are exempt, meaning you don't owe FICA on their wages regardless of amount. These include your spouse, your parent, your child under age 21, or any individual under age 18 if providing household services is not his or her principle occupation.

For FUTA, no tax is due on wages paid to a spouse, parents, or your child under age 21.

If you are liable for any nanny tax, you'll need an employer identification number (EIN); you can't use your Social Security number for tax-reporting purposes. You can obtain one easily (at no cost) from the IRS at www.irs.gov/businesses/small/article/0,,id=102767,00.html.

You also may owe state unemployment insurance and need to pay workers' compensation for household employees. Contact your state labor department for details—find a link to your state's department through the American Federation of State, County, and Municipal Employees (AFSCME) at www.afscme.org/publications/11820.cfm.

CHAPTER 2

Changes for Health Care and Education

Aside from buying a home, the two biggest expenditures for some families each year are health care and education. Most individuals must pay some or all of their health care costs (only a minority have all of their costs covered by employer plans). And when it comes to higher education, very few can afford the tuition and other costs without loans, financial aid, or other assistance. The tax law provides *some* help now when it comes to health care and education. New rules created by massive health care reform in 2010, however, drastically change the rules for health coverage in a number of ways over the next several years.

This chapter explains the tax changes affecting medical and education expenses. Some changes are new for 2010; others are set to expire at the end of 2010 unless Congress acts to extend them. And many additional changes that are set to take effect after 2010 are explained here so you can plan ahead.

Mandatory Health Coverage

Starting in 2014, every individual in the United States (with limited exceptions) will be required to have health coverage under a "play or pay" system. If an employer does not provide this coverage, then the individual must buy it. If

the individual cannot afford the coverage, certain assistance will be available. Those who fail to have coverage can be subject to a penalty.

The following summary of coverage requirements is only a brief overview of the subject to acquaint you with things to come. The IRS has yet to provide any guidance or clarification to help taxpayers better understand their coverage requirements; this guidance is sure to be forthcoming in future years.

Mandatory Coverage

Approximately 46.3 million individuals who lacked health coverage in 2009 (the last year for statistics) will have to be covered starting in 2014. Coverage can be purchased through a private insurance company or through a new American Health Benefits Exchange (AHBE), a government-supervised source for health coverage which has yet to be set up.

If you aren't covered by Medicare, Medicaid, an employer plan, or some other policy, you must obtain coverage not only for yourself, but also for your spouse and dependents.

If you fail to carry minimum coverage, you'll have to pay a monthly penalty, which is 1/12 of the greater of a flat amount or a percentage of income, as shown in Table 2.1. For uninsured minors (those under age 18), the penalty is one-half the amount imposed on adults.

A family's total penalty is capped at 300 percent of the per adult flat dollar penalty. For example, in 2014, the maximum penalty is $285 (300 percent of $95), even if 1 percent of income is greater than this amount.

PLANNING

Starting in 2014, employers offering minimum essential coverage through company-sponsored plans will be required to report employee enrollment in their plans to the IRS as well as furnish a written statement to each full-time

TABLE 2.1 Individual Penalty in Lieu of Coverage

Year	Penalty	Percentage of Income
2014	$ 95	1.0%
2015	325	2.0%
2016	695*	2.5%

*Adjusted for inflation after 2016.

employee, detailing the coverage. This is how the IRS will know whether you have the necessary coverage or should be subject to the penalty.

Health Insurance Premium Assistance Credit

Starting in 2014, if you purchase your own coverage and your income is below set limits, you can qualify for a federal tax credit to help you cover the cost of health insurance. The health insurance premium assistance credit is supposed to ensure that you pay no more than a certain percentage of your income to carry health coverage.

The credit ranges from 100 percent to 400 percent of the federal poverty level. Anyone with employer-provided health coverage cannot claim the credit unless the health coverage is below certain coverage standards or an employee's share of premium costs exceeds 9.5 percent of the employee's income.

The credit is refundable, which means you get a tax refund if the credit exceeds your tax bill for the year.

Coverage for Children under Age 27

In the past, employers and insurers limited coverage for employees' dependents to children still in school and/or under the age of 23 or so. Under the new law, employees' children under the age of 27 cannot be denied the same tax-free health benefits available to the employees' other dependents. Plans that provide dependent coverage must continue to make the coverage available for an adult child until the child turns age 26. The extended coverage must be provided not later than plan years beginning on or after September 23, 2010.

An eligible child does *not* have to be an employee's dependent, which means the child does not have to live with the employee or even earn less than a set amount.

If an eligible child is covered under your health plan and your employer pays some or all of the premiums for this coverage, the amount paid is fully excludable and not taxable to you. This exclusion became effective on March 30, 2010.

PLANNING

If a child reaches age 27 during the year, the child can continue on the parent's insurance through the end of the year; the coverage does not automatically end on the child's birthday.

Reporting on Your W-2

Starting in 2011, your W-2 form will reflect the value of health coverage obtained in the workplace. This amount must be included on your W-2 form whether you, your employer, or a combination of both pay for the coverage.

The reporting will not affect your taxes in any way. Employer-paid health coverage for you, your spouse, your dependents (and now your children under age 27) continues to be a tax-free fringe benefit.

Note: Starting in 2014, employers will be required to report to the IRS about "minimum essential health care coverage" that they provide to employees. This information will be used to determine whether you have the requisite health coverage to be exempt from the individual penalty discussed earlier.

Deductible Medical Expenses

Medical costs can be a sizable expense, even if you have health insurance coverage. Medical costs that are not covered by insurance (other than cosmetic surgery done for nonmedical purposes) can be deducted as an itemized deduction to the extent they exceed 7.5 percent of adjusted gross income (AGI).

The 7.5 percent of AGI floor is scheduled in increase to 10 percent starting in 2013. However, those who are age 65 and older can continue to use the 7.5 percent of AGI floor through 2016. The 10 percent floor currently applies for purposes of the alternative minimum deduction and will continue to be the floor in the future.

Example

In 2010, your adjusted gross income is $42,000. Your out-of-pocket medical costs are $5,000. You can treat as an itemized deduction $1,850 [$5,000 – ($42,000 × 7.5 percent)]. If you are subject to the alternative minimum tax (AMT), you can deduct only $800 for AMT purposes [$5,000 – ($42,000 × 10 percent)].

Medical expenses include qualified costs for yourself, your spouse, your dependents, and individuals who would qualify as dependents but for the fact that they have gross income over a set limit ($3,650 for 2010).

Example

You pay more than half the cost of support for your elderly parent, including $8,000 in medical costs. Your parent has gross income of $10,000 in 2010. You can't claim your parent as a dependent because of the gross income, but you can add $8,000 to your deductible medical costs in determining your itemized medical deduction.

Examples of deductible medical expenses include doctor and hospital bills, medical insurance premiums, and prescription drugs and insulin. As noted earlier, you cannot deduct the cost of cosmetic surgery unless it is done for medical purposes (to improve a disfigurement).

Each year there are new cases and IRS rulings on whether certain expenses qualify as deductible medical costs. Here is a round-up of developments within the past year or so.

Examples of deductible expenses:

- The cost of sex reassignment surgery for a person suffering from gender identification disorder (GID)
- The cost of storing umbilical cord blood for use in treating an existing or imminently probably disease

Examples of nondeductible expenses:

- Breast augmentation surgery for a person who undergoes sex reassignment surgery
- In vitro fertilization costs incurred by a healthy male to have a woman carry his child
- Infant formula for a healthy baby of a mother who could not nurse because of a double mastectomy
- The cost of storing umbilical cord blood as a precaution to treat a disease that might possibly develop in the future

Medical Driving

If you use your car, van, or pickup truck to visit a doctor, go to a pharmacy, travel to a therapy session, or for any other medical driving, 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

To deduct medical driving using the actual cost method or the standard mileage rate, you must keep a written record of the trips. Make a note of the mileage for each medical trip, along with the date and destination. Alternatively, use an App for your mobile device to report your medical travel information.

Long-Term Care Insurance

A portion of the premiums you pay for long-term care insurance is treated as a deductible medical expense. The portion is based on your age at the end of the year. The portions for 2010 have increased over 2009 limits. The deductible portion of long-term care insurance premiums for 2010, as compared with 2009, can be found in Table 2.2.

Starting in 2012, there will be a new government-supervised program for long-term care called Community Living Assistance Services and Supports (CLASS). This will be a voluntary contribution program paid through payroll deductions. Those who choose to participate will receive assistance for community living services when they experience functional limitations (e.g., the inability to provide self-care). The Department of Health and Human Services will set yearly premiums, which will have to be paid for at least five years to vest in the program. Cash benefits, which will be paid following a determination by a licensed health care practitioner, will not be less than $50 per day.

TABLE 2.2 Deductible Portion of Long-Term Care Premiums

Age at the End of the Year	2010	2009
40 or less	$ 330	$ 310
More than 40 but not more than 50	620	580
More than 50 but not more than 60	1,230	1,150
More than 60 but not more than 70	3,290	3,080
More than 70	4,110	3,850

PLANNING

If you are self-employed, you can add the portion of your long-term care insurance premiums to your other medical insurance and deduct the total from gross income; you are not limited to an itemized deduction.

Also check for state income tax breaks for long-term care insurance. New York, for example, has a 20 percent tax credit for long-term care insurance premiums; there is no cap on the premiums taken into account in figuring the credit because of age.

Long-Term Care Insurance Riders

Starting in 2010, commercial annuities can include a long-term care insurance rider. Withdrawals from these annuities to pay long-term care costs are tax free.

If you already own a commercial annuity, you are permitted to exchange it tax free for one with a long-term care rider. If you need to buy a policy, expect to pay 35 percent to 50 percent more than standalone coverage for this hybrid annuity.

PLANNING

Life insurance policies can be exchanged tax free for annuity policies with riders. However, annuity policies with riders cannot be exchanged tax free for life insurance policies.

Health Savings Accounts

Health savings accounts (HSAs) started in 2004, and today over 10 million people are covered by them. HSAs are a way for many Americans to obtain affordable health care. They combine a high-deductible (low-cost) health plan (called an HDHP) with an IRA-like savings account. While health care reform made a couple of minor changes to HSAs, essentially there are no major revisions so that HSAs continue to be a viable health coverage option for individuals and businesses.

HSAs provide a *triple* tax benefit:

1. Contributions (up to set limits) are tax deductible.
2. Earnings on contributions grow on a tax-deferred basis (there are no annual taxes on the account).
3. Withdrawals to pay medical costs not covered by insurance are tax free.

TABLE 2.3 HDHP Limits for 2010

	Self-Only	Family
High-deductible health plan deductible at least	$1,200	$ 2,400
Policy out-of-pocket expense limit	5,950	11,900
Deductible contribution limit	3,050	6,150
Additional contribution for being age 55 or older	1,000	1,000 per spouse

To be eligible to make contributions, you must be covered by an HDHP. This means an insurance plan that has a minimum insurance deductible and a cap on out-of-pocket costs. The HDHP limits for 2010 can be found in Table 2.3, and the HDHP limits for 2011 can be found in Table 2.4.

Once you are covered by an HDHP, through either a policy at work or one that you purchase on your own, then you can make tax-deductible contributions to an HSA. You do not have to contribute the full amount up to the deduction limit; you can add whatever you can afford. If your employer contributes to your HSA, you cannot deduct this contribution; you are not taxed on your employer's contribution to your HSA.

Contributions can be made up to the due date of the return. For example, 2010 contributions can be made through April 15, 2011; you do not gain any extra time if you have an extension of time to file your return.

PLANNING

Looking ahead, decide whether an HSA is right for you. In planning, consider the contribution limits that apply for 2011 (they may be adjusted annually for inflation after 2011).

Contributions can be made by depositing a tax refund into an HSA (as in the case of an IRA, explained in Chapter 3). Just give the IRS the account number

TABLE 2.4 HDHP Limits for 2011

	Self-Only	Family
High-deductible health plan deductible at least	$1,200	$ 2,400
Policy out-of-pocket expense limit	5,950	11,900
Deductible contribution limit	3,050	6,150
Additional contribution for being age 55 or older	1,000	1,000 per spouse

and routing number for the HSA. If you want to use a 2010 tax refund to make a 2010 contribution, you'll need to file your 2010 income tax return early enough so that the return is processed and the funds transferred to the HSA according to your instructions before the April 15, 2011, deadline.

You must keep track of your medical costs for the year. You don't have to file the bills or receipts with your tax return; retain them in case you are audited and the IRS asks you to prove that distributions from your HSA were taken for medical purposes.

HSAs do *not* have a use-it-or-lose-it feature associated with flexible spending accounts. Any money you don't withdraw from the HSA by the end of the year continues to grow within the account.

You can use HSA funds for any purpose, but you'll pay income tax on the withdrawal *plus* an early distribution penalty if you're under age 65 and use the funds for nonmedical purposes (the penalty is waived for distributions on account of disability or death). The penalty for 2010 is 10 percent; the penalty doubles to 20 percent starting in 2011. Because there is no penalty once you reach age 65, many have suggested that healthy individuals can use HSAs for retirement income. If the IRS levies on your HSA to cover taxes you owe and you're under age 65, you'll owe the penalty even though the withdrawal was involuntary.

Starting in 2011, penalty-free withdrawals for those under age 65 are restricted to prescribed medications and insulin. Thus, withdrawals to pay for over-the-counter medications for self-medicating (e.g., aspirin or cold syrup) no longer qualify as tax-favored withdrawals *unless* there is a doctor's prescription.

For more information about HSAs, visit www.hsainsider.com, www.healthdecisions.org, www.hsafinder.com, and www.ehealthinsurance.com.

Health Reimbursement Accounts

Health reimbursement accounts (HRAs) are arrangements in which employers (not employees) make "contributions" that allow employees to tap into a fixed sum each year to pay health costs not covered by insurance. (HRAs are an alternative to HSAs and are used by an increasing number of companies.) The employees' accounts are not funded (they cannot be transferred when leaving employment); they are merely the company's bookkeeping entry on employees' behalf. However, unused funds carry over to future years.

Like health savings accounts, reimbursements from HRAs after 2010 are limited to prescription drugs and insulin. Over-the-counter medications can be reimbursed only with a doctor's prescription.

Exclusion for Benefits Paid from Long-Term Care Policies

The costs of long-term care for a chronic illness or simply for the frailties of old age are not covered by Medicare or other standard health insurance policies. Some people carry a long-term care policy to pay for in-home assistance or nursing home care. If you have a long-term care insurance policy and require long-term care, some or all of the benefits paid under the policy are tax free.

Payments made from a long-term care policy to cover long-term care costs are fully tax free.

If, under the terms of the policy, you receive a daily dollar benefit without regard to your long-term care costs, you can exclude up to $290 a day in 2010 (up from $280 a day in 2009).

Exclusion for Accelerated Death Benefits

Life insurance is designed to pay benefits to a named beneficiary when the insured dies; all of the proceeds of a life insurance policy paid at death are tax free. However, some life insurance policies may allow payments to be made to the insured during his or her lifetime because of health conditions. If you have a life insurance policy that permits benefits to be paid for long-term care, the benefits used for this purpose may be partially or fully tax free.

Accelerated death benefits made from a life insurance policy to an insured who is terminally ill are tax free under an accelerated death benefit clause. A person is terminally ill if he or she has a noncorrectable illness or condition that is expected to result in death within 24 months of a physician's statement of this fact.

Accelerated death benefits made from a life insurance policy to an insured who is chronically ill are excludable up to $290 a day in 2010 (up from $280 a day in 2009). A chronically ill person is someone who has been certified by a licensed health care practitioner within the preceding 12 months as being unable to perform for a period of at least 90 days at least two of the following activities without assistance: eating, toileting, dressing, bathing, continence, or transferring (getting in and out of bed).

TABLE 2.5 Medicare Part B Premiums for 2010

MAGI of Singles	MAGI of Marrieds	Monthly Premium
Over $85,000 but not over $107,000	Over $170,000 but not over $214,000	$154.70
Over $107,000 but not over $160,000	Over $214,000 but not over $320,000	$221.00
Over $160,000 but not over $214,000	Over $320,000 but not over $426,000	$287.30
Over $214,000	Over $426,000	$353.60

Medicare Part B

The basic monthly period for Medicare Part B premium in 2010 is $96.40. However, some Medicare recipients can be charged considerably more each month; it depends on modified adjusted gross income, or MAGI. Generally, your MAGI two years prior to the year of paying the premiums determines what those premiums will be. In effect, your MAGI for 2010 will impact your 2012 Part B premiums, even if you aren't on Medicare in 2010 or 2011. About 5 percent of current Medicare recipients are subject to the additional premium costs. These additional premiums can be quite steep. As an example, Table 2.5 shows the Medicare Part B premium schedule for 2010 (the tables for 2011 and later are not yet available).

For 2011, the basic monthly premium rate will remain at $96.40 for about 75 percent of Medicare beneficiaries because of very low inflation in 2010; the other 25 percent of beneficiaries (new Social Security recipients, high-income individuals subject to the surtax, and low-income individuals whose premiums are paid by their state) face a higher basic premium of $120.20 per month (the estimated amount at the time this book went to press).

PLANNING

Your MAGI for 2010 determines your Medicare Part B premiums in 2012 if you plan to receive benefits at that time. Strategies for controlling MAGI include the following:

- *Use salary reduction options to decrease AGI/MAGI.* To the extent you reduce your income, your AGI/MAGI is lower. You can so do without forgoing earnings by taking advantage of various salary reduction arrangements you

may be offered. These include making contributions to 401(k) plans, 403(b) annuities, and Savings Incentive Match plans (SIMPLEs), and contributing to flexible spending arrangements to pay for medical and dependent care expenses on a pretax basis. The amounts you contribute to salary reduction arrangements are *not* treated as current income—they are not included in your W-2 pay—so your AGI is lower even though you obtain a tax benefit from your earnings (retirement savings, selection of benefit options, etc.).

- *Invest for tax-free or tax-deferred income to decrease AGI/MAGI.* To the extent you can avoid reporting income this year, you can keep your AGI/MAGI down. Consider investing in tax-free bonds or tax-free bond funds if you are in a tax bracket above 25 percent. Also consider deferral-type investments—U.S. savings bonds and annuities—where income is not reported until a future year. You may even wish to switch from dividend-paying stocks to growth stocks to eliminate current income while attaining appreciation that will be reported as capital gains later on (even though dividends are taxed at the same low rates as capital gains, they are still counted in full in determining AGI/MAGI).
- *Sell on an installment basis or make a tax-free exchange to decrease AGI/MAGI.* An installment sale spreads your gain over the term you set so that your income won't spike in the year of the sale. Or defer the gain by making a tax-free exchange of investment or business property—gain realized on the initial exchange is postponed until the property acquired on the exchange is later disposed of. The wisdom of installment sales is discussed in Chapter 6.
- *Use year-end strategies to decrease AGI/MAGI.* Defer income to minimize your AGI/MAGI for the current year. ***Important:*** Increasing your itemized deductions, such as deductions for medical expenses or charitable contributions, by accelerating discretionary payments won't cut your AGI/MAGI (itemized deductions are taken into account *after* you figure your AGI). Again, the advisability of these year-end strategies in light of pending tax law changes is discussed in Chapter 6.
- *Take advantage of above-the-line deductions to decrease AGI/MAGI.* Make full use of the $3,000 capital loss write-off against ordinary income—make sure that you realize sufficient losses before the end of the year to do so while enabling you to reposition your holdings.

- *Do not report a child's income on your return to increase AGI/MAGI.* If you have a child subject to the kiddie tax (see Chapter 1), reporting the child's income on your return, even though you can eliminate the need to file a separate return for the child, increases your AGI.

COBRA Subsidy

COBRA (an acronym for the Consolidated Omnibus Budget Reconciliation Act) is a federal law requiring employers that regularly employ at least 20 workers and that offer health coverage to allow workers who leave the job to continue in the group plan for 18 months. Usually, the employee pays the full cost of COBRA coverage, plus an administrative fee of up to 2 percent of premiums.

Under a special rule, certain terminated workers can receive federal assistance for COBRA premiums. An assistance-eligible individual pays only 35 percent of COBRA premiums for 15 months; the federal government pays the other 65 percent of premiums for this period (the employer pays this portion and receives reimbursement from the government via a reduction of employment taxes).

To qualify for the COBRA subsidy, you must have been involuntarily terminated from employment on or after September 1, 2008, and before May 31, 2010. You don't get the subsidy if you left the job for your own reasons even though you are entitled to COBRA (you pay all of it in this case). Once involuntarily terminated, you must make a timely election for COBRA coverage.

You receive the subsidy regardless of the amount of your income for the year. However, the subsidy is fully tax free to you only if your MAGI does not exceed a set amount ($125,000 for singles or $250,000 for joint filers). If your MAGI exceeds the limit, there is a phaseout, so that all of the federal subsidy is included in gross income when MAGI exceeds $145,000 ($290,000 or joint filer's).

PLANNING

If you are eligible for this COBRA subsidy, decide whether it is less costly than obtaining health coverage elsewhere. For example, it may be less costly to seek individual coverage to obtain the type of benefits you need and not pay for those you don't (which may be part of the price of the employer's coverage).

Note that the federal subsidy runs for only 15 months but you can continue federal COBRA for another three months (18 months in total). If your employer

pays for some months of COBRA, this reduces the period of the federal subsidy. For instance, if your employer lays you off and agrees to pay all of your COBRA costs for three months, you can then obtain the federal subsidy for only 12 months (not the usual 15 months).

Even if you work for an employer who is not subject to federal COBRA (there are fewer than 20 workers on the payroll), a state law, called mini-COBRA, may apply. The 15-month federal subsidy can be used to the extent of your state's COBRA coverage period.

Flexible Spending Accounts

Flexible spending accounts (FSAs) enable employees who participate to pay for medical expenses not otherwise covered by insurance on a pretax basis. Funds are contributed from employees' salary (and are not taxed as earnings). Then, withdrawals used to pay medical expenses are not taxed. While there are no tax changes affecting FSAs in 2010, changes are set for future years.

Reimbursements

In 2010, reimbursements can be made on a tax-free basis for any medical expenses, including over-the-counter medications such as cold remedies and aspirin.

In one situation, reimbursement for herbs was allowed where *all* of the following conditions were satisfied:

1. The employee with the FSA had a medical condition (disease, illness, or injury),
2. The employee was purchasing the herb to treat or alleviate this medical condition, and
3. The herb would not have been purchased "but for" the medical condition.

Starting in 2011, there can be no tax-free reimbursements for over-the-counter medications, unless prescribed by a doctor to treat an illness, disease, or condition, you need a doctor's note, for example, for reimbursement of over the counter cough syrup.

PLANNING

If your employer's FSA has a "grace period" that allows you to use up 2010 contributions through March 15, 2011, withdrawals during this period still fall under 2010 rules (i.e., you can submit reimbursements for over-the-counter medications without a doctor's prescription).

Contribution Cap

Currently, employers are free to set the annual cap on employee contributions to FSAs. Starting in 2013, the tax law sets the cap. The maximum employee contribution to an FSA via a salary reduction will be limited to $2,500 for the year. After 2013, the $2,500 cap will be indexed for inflation in $50 increments.

Health Coverage Credit for Displaced Workers

Certain displaced workers may be eligible for a refundable tax credit to pay for health insurance coverage. The credit is 80 percent of premium costs for coverage months beginning on or after May 1, 2009, and before January 1, 2011, with no dollar limit. Before May 1, 2009, and after December 31, 2010, the credit is 65 percent of premium costs.

Eligible workers include workers who qualify for trade adjustment assistance (TAA) as well as those age 55 or older who are not eligible for Medicare but are receiving payments from the Pension Benefit Guaranty Corporation (PBGC). For any eligible coverage month beginning after February 17, 2009, and before January 1, 2011, a TAA recipient need not participate in a training program in order to receive the health coverage credit.

Family members of eligible workers can continue to be qualified as well even though an otherwise disqualifying event has occurred. For example, the spouse of an eligible worker is also eligible, even following divorce. The same is true following the death of an eligible worker.

The credit can be used only to cover COBRA or obtain coverage under a spouse's employer's plan or a state-sponsored insurance program. The credit may not be used to pay for individual coverage unless the worker has had such coverage for at least 30 days prior to losing his or her job.

The credit can be enjoyed on an advanced payment basis, with the 80 percent amount paid directly to the health care provider for the qualified insurance.

Education Tax Credits

The cost of attending college or graduate school can be staggering. Even with financial aid, many families still pay out of pocket to finance higher education. If you pay higher education costs for yourself, your spouse, or your dependent, you may be eligible to claim an education credit. There are two credits available in 2010: the American Opportunity credit (which temporarily replaces the former Hope credit) and the Lifetime Learning credit.

In determining whether you are eligible for either credit and how much to claim, note that income limits apply. You can claim an education credit even if you borrow the money to pay education costs.

American Opportunity Credit

This credit, which applies in 2010, is an improved version of the Hope credit, which had applied prior to 2009 and will again apply after 2010 (unless Congress extends the American Opportunity credit). The amount of the American Opportunity credit is 100 percent of the first $2,000 of qualified tuition and related fees, plus 25 percent of the next $2,000 of such expenses, for a top credit of $2,500. The Hope credit had been limited to 100 percent of the first $1,200 of qualifying tuition and expenses, plus 50 percent of the next $1,200, for a total credit of $1,800.

The American Opportunity credit applies for the first four years of higher education. The Hope credit had applied only for the first two years of higher education. The credit can be claimed each year as long as the student has not exceeded the limit on the number of years of schooling.

The credit continues to be figured on a per-student basis. Thus, if your older child is a sophomore in college and your younger child is a freshman in college and you are paying some or all of their education costs, you can claim a total credit of up to $5,000 for both of them combined.

The items treated as qualified tuition and related expenses have been expanded to include course materials—books, supplies, and equipment needed

for a course of study, whether or not the materials are purchased from the school.

The American Opportunity credit is partially refundable. You can recoup 40 percent of the credit amount even though it exceeds your tax liability for the year.

The credits are figured on Form 8863, *Education Credits* (see Appendix C).

Alert

The American Opportunity credit does not apply after 2010 unless Congress extends it. The former Hope credit is set to reapply in 2011. The Hope credit is 100 percent of the first $1,200 of qualified expenses, plus 50 percent of the next $1,200, for a maximum credit of $1,800. The Hope credit is limited to the first two years of higher education and has the same modified adjusted gross income limits applicable to the Lifetime Learning credit, discussed below. Check the Supplement for details.

Lifetime Learning Credit

The Lifetime Learning credit is an alternative credit to the American Opportunity credit. It is not limited to the first four years of higher education and can be used for graduate school as well.

The credit limit has not changed in any way over the past couple of years. It remains at 20 percent of the first $10,000 of qualified tuition and related fees, for a top credit of $2,000.

The credit applies on a per-taxpayer basis, regardless of the number of students in your family who are in college or graduate school. Thus, if you claim the credit for expenses you paid for yourself to take a graduate-level course and for your child who is in his fifth year of college, your total credit is limited to $2,000.

Income Limits

Either of the education credits may be claimed only if your modified adjusted gross income is below set limits. The MAGI phaseout ranges have not changed in 2010 (see Table 2.6).

TABLE 2.6 MAGI Phaseout Ranges for Higher Education Credits

Filing Status	American Opportunity Credit	Lifetime Learning Credit
Single	$80,000 to $90,000	$50,000 to $60,000
Married filing jointly	$160,000 to $180,000	$100,000 to $120,000

PLANNING

If your MAGI prevents you from claiming the credit, your child may be able to claim the credit, even though you paid the education expenses. In order for your child to claim the credit, you must waive a dependency exemption for your child (an action that may not result in a significant tax cost to you if your exemptions are already subject to the partial phaseout because of your high income or if you are subject to the alternative minimum tax). A waiver doesn't require you to fill out any special form or statement; just don't claim the exemption on your return. To benefit from this strategy, your child must have tax liability (e.g., resulting from mutual fund distributions). In deciding whether to let your child claim the credit, weigh the tax savings you'd receive from claiming the exemption against the tax savings to your child so you can then choose the option that provides the greater tax benefit for the family. If you decide to let your child claim the credit and it is the American Opportunity credit, your child *cannot* use it to obtain a tax refund in excess of his or her tax liability; the 40 percent refundable rule does not apply in this situation.

Tuition and Fees Deduction

Instead of claiming an education credit, you may be able to deduct tuition and fees paid for higher education. This deduction is taken to arrive at adjusted gross income (i.e., you don't need to itemize personal deductions in order to claim the deduction for tuition and fees).

Alert

This deduction does not apply after 2009 unless Congress extends it; check the Supplement for details on an extension for 2010.

TABLE 2.7 MAGI Limit for Tuition and Fees Deduction

Filing Status	MAGI Limit for $4,000 Deduction	MAGI Limit for $2,000 Deduction
Married filing jointly	Not more than $130,000	More than $130,000 but not more than $160,000
Other taxpayers	Not more than $65,000	More than $65,000 but not more than $80,000

The deduction is capped at $4,000 of tuition and fees paid for yourself, your spouse, or a dependent for those with MAGI below a set amount. There is a $2,000 limit for those with higher MAGI, as shown in Table 2.7.

PLANNING

Assuming the deduction is extended for 2010, then even one dollar of MAGI over the limit bars the deduction; there is no phaseout. This means careful planning of income where appropriate to keep MAGI below the limit (MAGI planning is discussed earlier in this chapter).

The deduction cannot be taken if an education credit is claimed. Which is better taxwise (assuming you are eligible to make a choice)? It depends. You can make a decision by comparing the tax savings that each type of write-off would produce for you. Use the following worksheet to compare tax savings:

Tuition and Fees Deduction		Education Credit	
Amount of deduction	$_______	Amount of credit	$_______
× your tax bracket	$_______		
Tax savings	$_______	Tax savings	$_______

Example

You're a single parent who pays $10,000 for your child's college tuition. Your tax bracket is 28 percent (assume you qualify for the American Opportunity credit). A $4,000 deduction for tuition and fees would produce a tax benefit of $1,120. Your tax credit would be $2,500 in this case, resulting in a greater tax benefit.

TABLE 2.8 Savings Bond Interest Phaseout Ranges

Filing Status	2010 MAGI	2009 MAGI
Single	$70,100 to $85,100	$69,950 to $84,950
Married filing jointly	$105,100 to $135,100	$104,900 to $134,000

Savings Bond Interest

You can exclude from income the interest earned on series EE or I U.S. savings bonds that you redeem to pay for qualified higher education costs for yourself, your spouse, or a dependent. The exclusion applies only to interest on bonds purchased in your name after 1989; you must have been at least 24 years old at the time of purchase.

You can claim the exclusion only if your MAGI is no more than a set limit. This limit is adjusted annually for inflation. Table 2.8 shows the MAGI limit for fully or partially excluding savings bond interest based on your filing status for 2010 compared with 2009.

Example

You're a single parent and redeem bonds in 2010 to pay your child's college tuition. Interest on the redeemed bonds is $4,000 (all of which is used to pay qualified costs). If your MAGI is below $70,100, you may exclude all of the interest. If your MAGI is $77,600, you may exclude $2,000 of interest from your income. If your MAGI is over $85,100, you cannot exclude any interest.

Use Form 8815, *Inclusion of Interest from Series EE and I U.S. Savings Bonds Issued After 1989* (see Appendix C) to figure the excludable interest.

PLANNING

Many people make gifts to babies and children in the form of savings bonds. Recognize that these gifts won't qualify for the interest exclusion even though they may be redeemed to pay for higher education costs. The reason: The bond owner (the child) isn't over age 24 and didn't purchase them him/herself.

TABLE 2.9 MAGI Phaseout Ranges for Student Interest Deduction

Filing Status	Phaseout Range
Single	$60,000 to $75,000
Married filing jointly	$120,000 to $150,000

Instead, consider giving gifts to a child's 529 account if one has been set up for the child.

Student Loan Interest Deduction

Most students pursuing higher education cannot pay the tab without relying to a greater or lesser extent on student loans. At some point, the loans must be repaid. If you are repaying student loans, you may be able to deduct some of the interest. The tax law lets you deduct interest on student loans up to $2,500; this limit has not changed. This deduction is an adjustment to gross income, so you can take it regardless of whether you itemize your other deductions.

The deduction can be claimed only if your MAGI is below set amounts. Table 2.9 shows the phaseout ranges, based on your filing status, for 2010; these amounts are unchanged from 2009.

Example

You're single and have just graduated from college. If your MAGI for 2010 is below $60,000, you may deduct interest on your student loans up to a maximum of $2,500. If your MAGI is $65,000, you may deduct up to $1,250 of interest from your income. If your MAGI is over $70,000, you cannot deduct any interest on your student loans.

Section 529 Plans

Saving for college is challenging, especially in tough economic times when there are many demands on a family's budget. However, taking a long view for college savings can reduce the funds needed to be added each year. One of the best savings plans for college is the 529 plan (the name comes from the section in the Internal Revenue Code governing it).

There are two types of plans:

1. A prepaid tuition plan, which guarantees to cover some or all of tuition costs, depending on your contributions.
2. A savings plan, which provides funds based on investment performance of your contributions.

With both types of plans, there is no federal income tax deduction for contributions (there may be state-level deductions or credits for making contributions). However, earnings grow tax deferred and withdrawals are completely tax free if used to pay qualified higher education expenses. Qualified higher education expenses include tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible educational institution (any college, university, vocational school, or postsecondary school eligible to participate in federal student loan programs). Room and board are also a qualified higher education expense if the student is at least a half-time student.

Computer Technology

For 2009 and 2010 only, qualified higher education expenses also include technology equipment. This means computers, Internet access fees, and software. However, it does not include software for games, sports, or hobbies unless the software is "predominantly educational in nature."

PLANNING

A computer that is paid for by funds from a 529 plan does not have to be used *exclusively* for educational purposes to qualify for the exclusion.

If you are considering a purchase for a student using 529 plan funds, do so before the end of 2010 in case this break is not extended for 2011.

Changing Investments

The tax law usually lets you change your 529 plan investment selections once a year and whenever there is a change in the beneficiary. However, due to the state of the economy in 2008 and 2009, the IRS had said that *two* investment

changes were permissible in 2009. Whether the IRS will extend this rule to 2010 depends on how the economy progresses; at the time of publication of this book it had *not* extended the two-investment-change rule for 2010.

Coverdell Education Savings Accounts

There is a modest opportunity to save for education using a Coverdell Education Savings Account (ESA). For 2010, expansive rules apply; after 2011, more restrictive rules are set to become effective as in years prior to 2002. Here are the rules for 2010 and what they may become in 2011 so you can plan ahead.

In 2010, you can contribute up to $2,000 to an ESA for a beneficiary who has not attained the age of 18 at the time the contribution is made. There is no age cap on contributing to an ESA on behalf of a beneficiary who has special needs because of a physical, mental, or emotional condition (e.g., a person with a learning disability). The $2,000 cap is applied per beneficiary (not per contributor). Annual contributions in excess of this limit are subject to a 6 percent excise tax.

There is no familial requirement for contributors, meaning you can make a gift to a niece's ESA or even a neighbor's ESA. However, there is an income limit for all contributors, as shown in Table 2.10.

Contributions are not tax deductible. However, withdrawals for qualified expenses in 2010 are fully tax free. Qualified expenses include costs for primary and secondary school (public, private, or religious), as well as college and graduate school. Such costs include tuition, fees, room and board, academic tutoring, books, computers and Internet access, supplies, transportation, and uniforms.

Distributions are tax free even if an education credit is claimed for the student as long as the same tax-free distribution is not the basis for the credit.

TABLE 2.10 MAGI Phaseout Ranges for Coverdell ESA Contributors

Filing Status	Phaseout Range
Married filing jointly	$190,000 to $220,000
Other taxpayers	$95,000 to $110,000

Alert

Unless the 2010 rules for Coverdell ESAs are extended, these education-savings vehicles will change dramatically in 2011. Here are some changes to anticipate:

- **Annual contribution will be limited to $500.**
- **Income limit on contributors will have a marriage penalty because the phaseout range for singles will remain $95,000 to $110,000, but will decline to $150,000 to $160,000 for joint filers.**
- **Distributions (even those used for qualified education costs) will be taxed according to the rules used for commercial annuities (i.e., a portion of withdrawals will be taxable and a portion tax free).**
- **Qualified education costs will be limited to college and graduate school.**
- **Qualified expenses will include only tuition and fees, books, supplies, and equipment.**
- **An education credit cannot be claimed if any ESA funds are excluded from income.**

PLANNING

Before the end of 2010, it is advisable to roll over funds from the ESA to a 529 plan; this can be done on a tax-free basis.

Alternatively, consider drawing down the account for qualified education costs to avoid future taxation.

CHAPTER 3

New Breaks for Retirement Planning

Social Security continues to be a main source of retirement income for many Americans. However, if you want a secure financial future, it's up to you to save, and the best way to do this is to take advantage of tax incentives for retirement savings. These include tax-advantaged accounts, such as individual retirement accounts (IRAs) and 401(k) plans, as well as personal savings (investments are discussed in the next chapter). Saving is more important than ever in light of the dramatic decline in account values (in most cases they have not recovered to prerecession levels) and the extremely modest investment returns that can be enjoyed currently.

Your retirement savings choices depend in part on your income level and whether your employer gives you the opportunity to participate in a company-sponsored plan.

This chapter explains the basic rules for contributions to IRAs and Roth IRAs. It also covers the new opportunity for converting to Roth IRAs in 2010 and later years. Further, the chapter also details other breaks and developments affecting retirement planning.

Individual Retirement Accounts

Individual retirement accounts were created in 1974 to enable workers who were not covered by company retirement plans to save for their retirement on a tax-advantaged basis. In the past 36 years, IRAs have grown to be vehicles for substantial retirement savings. You can reduce the income that is taxed while saving for your retirement by adding money to an IRA. There are three basic types of IRAs: traditional (deductible) IRAs, nondeductible IRAs, and Roth IRAs. While the contribution limits for all deductible IRAs in 2010 remain unchanged from 2009, several other rules are different.

Contribution Limit

The maximum contribution to an IRA in 2010 is $5,000. Those who will be at least 50 years old by the end of the year can add another $1,000, for a total contribution limit of $6,000. If a married person has a nonworking spouse and both spouses are at least 50 years old, the working spouse can add $6,000 to each spouse's IRA, for a total of $12,000 in savings in 2010.

The amount of the IRA contribution cannot exceed the amount of the person's earned income, so a part-timer earning $3,000 in 2010 cannot contribute more than $3,000.

Other Basic IRA Rules

The basic rules for IRA contributions remain unchanged for 2010. To fund any type of IRA, you need earned income from a job or self-employment, taxable alimony, combat pay for which an election has been made to treat the pay as taxable, or wage differential payments (certain payments made by employers to employees activated for military service for more than 30 days). For married couples, if one spouse has earnings, he or she can make a contribution to an IRA or Roth IRA for the nonworking spouse.

To add money to a traditional or nondeductible IRA, you must be under age 70½. There is no age limit for adding money to a Roth IRA. There is no minimum age, so, for example, teenagers who work can add money to an IRA or a Roth IRA.

You can set up an IRA with most financial institutions, including banks, brokerage firms, insurance companies, and mutual funds. Contributions must

be made in cash (e.g., you can't use shares of stock to make contributions). IRA contributions can be invested in a wide array of financial products, including certificates of deposit (CDs), stocks, bonds, mutual fund shares, annuities designed specifically for IRAs, and even real estate (with restrictions); you cannot invest in collectibles other than gold, silver, platinum and palladium bullion, state-issued coins, and certain U.S.-minted gold, silver, and platinum coins.

Contributions for IRAs can be made up to the due date of the return for the year. For example, a 2010 IRA contribution can be made anytime starting January 1, 2010, and ending April 15, 2011. Even if you obtain a filing extension for your 2010 return, you don't have additional time to make an IRA contribution.

Eligibility to Make Deductible IRA Contributions

If you participate in a qualified retirement plan, such as a company profit-sharing plan or pension plan, you can make deductible IRA contributions only if your modified adjusted gross income (MAGI) is below set limits. MAGI over a set limit causes the contribution limit to be phased out; it is fully phased out when MAGI exceeds another limit. The phaseout limits can be adjusted for inflation in 2011 and later years. The phaseout range is listed in Table 3.1; you'll note that only the range for singles has increased for 2010.

If one spouse is an active participant and the other spouse is not, the spouse who is not covered by a qualified retirement plan can make IRA contributions. There is a higher phaseout range in this case. The phaseout range based on the couple's combined MAGI in 2010 is $167,000 to $177,000; in 2009, it was $167,000 to $177,000.

No contributions can be made to or deductions claimed for inherited IRAs. However, a surviving spouse who inherits a deceased spouse's IRA and rolls it

TABLE 3.1 MAGI Phaseout Ranges for IRAs

Filing Status	2010	2009
Single	$56,000 to $66,000	$55,000 to $65,000
Married filing jointly	$89,000 to $109,000	$89,000 to $109,000
Married filing separately	$0 to $10,000	$0 to $10,000

TABLE 3.2 MAGI Phaseout Ranges for Roth IRAs

Filing Status	2010	2009
Single	$105,000 to $120,000	$105,000 to $120,000
Married filing jointly	$167,000 to $177,000	$166,000 to $176,000
Married filing separately	$0 to $10,000	$0 to $10,000

over to his or her own IRA can treat the IRA as his or her own and add to it in the future if otherwise eligible to do so.

Eligibility to Make Roth IRA Contributions

You can make a Roth IRA contribution regardless of whether you also are covered by a qualified retirement plan. However, the ability to contribute to an IRA depends on your MAGI. If your MAGI is too high, you cannot fund a Roth IRA. The phaseout range for 2010, as compared with 2009, can be found in Table 3.2; you'll note that only the range for joint filers has increased.

You cannot make contributions to an inherited Roth IRA if you are a nonspouse beneficiary; a spouse who treats an inherited Roth IRA as his or her own account can make regular or conversion contributions to it.

Planning for IRAs

Traditional IRA versus Roth IRA

Suppose you are eligible to contribute to either type of account. Which one makes more sense for you? Remember, the dollar limit on contributions for the year applies to the aggregate of contributions to a traditional and a Roth IRA, so if you are under age 50 and add $5,000 to a traditional IRA in 2010, you're barred from adding anything to a Roth IRA in 2010.

Generally, younger people with many years before retirement who are eligible to make either a deductible IRA contribution or a Roth IRA contribution probably should opt for the Roth IRA. The loss of the current income tax deduction probably is not as significant as the opportunity to build up tax-free income for retirement.

If you are 70½ or older and still working, you may be eligible to contribute to a Roth IRA because there is no age limit on contributors. This age, however, bars you from contributing to a traditional IRA.

Nondeductible IRAs

If you are an active participant who is barred from making traditional IRA contributions because of your MAGI for 2010, you can still make a nondeductible contribution (assuming you have earned income and are under age $70^1/_2$). Such a contribution may make sense if you plan to convert an IRA to a Roth IRA. While there are no income limits on converting to a Roth IRA (discussed later in this chapter), there are still income limits for making annual Roth IRA contributions, so putting funds into a nondeductible IRA first is a way to create a convertible pot.

Understand, however, that nondeductible IRA contributions complicate record keeping. This is because distributions from an IRA that includes nondeductible contributions are only partially taxable; a portion of the distribution related to the nondeductible contributions is tax free. You may need to work with a tax advisor to figure out how much of the Roth IRA conversion is taxable when you make the conversion from a nondeductible IRA.

Working Couples

If, as a couple, you have only limited funds to contribute to retirement savings, it's important to coordinate where the family funds should be directed so that they'll do the most good. Take into account several factors if you have to make this important decision:

- *Eligibility for plan participation*. If both couples are eligible to participate in their companies' plans, then decide which plan offers the greater benefit (factoring in employer matching contributions and investment options, discussed later). If only one spouse is eligible to participate in a plan, then decide whether funds should be directed to that plan or to IRAs.
- *Employer matching contributions*. Obviously contributions should be made where they'll earn the greater employer matching contributions. For example, if one spouse's plan has 3 percent matching and the other plan has 6 percent matching up to a set limit, the latter plan is probably the better option.
- *Investment options*. A 401(k) plan is required to provide a menu of investment options so you can structure the type of retirement savings portfolio that is best suited to your investment temperament, number of years

remaining until retirement, and other factors. Compare the options under each plan. If you opt for an IRA, you can have virtually an unlimited number of investment options by setting up a self-directed IRA.

Tax Savings

Consider using so-called found money, such as a tax refund or the payroll savings from the Making Work Pay credit, to fund your retirement accounts. You can even fund your IRA using a tax refund *before* you actually receive the refund from the government. Here's how: File your return early enough to allow time for the IRS to process it and transfer the funds to the IRA according to your instructions before the April 15 deadline. Include your IRA account information (account number and routing number) on your tax return. This way, the IRS automatically will transfer your refund directly into your IRA. However, it's up to you to alert your IRA account manager that the funds coming into the account from the IRS are to be applied toward a prior-year contribution.

Example

You are owed a $3,000 tax refund for 2010 after factoring in a contribution of $5,000 to a traditional IRA (assume you are eligible to make a deductible contribution). You file your 2010 income tax return electronically with the IRS at the beginning of March 2011, reporting the IRA contribution as if it had already been made. You include your IRA account information and have the entire $3,000 refund sent to your IRA (you also add $2,000 out of pocket to complete the $5,000 contribution). You inform the IRA custodian that the funds transferred into your account represent a prior-year contribution (for the 2010 tax year).

Roth IRA Conversions

You can create an IRA in two ways: by making annual contributions, as explained earlier in this chapter, and/or by converting a traditional IRA or qualified retirement plan account, such as a 401(k) plan, into a Roth IRA. You can make a Roth IRA contribution and a conversion in the same year.

Starting in 2010, the former $100,000 adjusted gross income limit, as well as the bar to married persons filing separately, no longer apply. Anyone is now eligible to convert some or all of their IRA accounts to a Roth IRA.

When you make the conversion, the income that would have been taxed had you taken a distribution from the traditional IRA or qualified retirement plan account becomes fully taxable. For those with traditional (deductible) IRAs or a 401(k) plan, this means all of the funds that are converted are taxable.

There is a special rule for conversions made in 2010 only. Fifty percent of the resulting income is reported as income in 2011 and the other 50 percent in 2012. However, you can opt to report *all* of the conversion income in 2010 and not use the deferral option. Which way is better? It's difficult to answer this now, because the tax rates that will be in effect after 2010 have yet to be set by Congress. The rates could be higher after 2010 (especially for higher income taxpayers), making it better to report all of the income in 2010. However, deferral means you take only half of the income into account in each of two years. This spread could lower the tax bracket you are in, depending, of course, on the amount of conversion income and your other income.

PLANNING

Conversion isn't an all-or-nothing decision; you can convert some or all of your IRA or IRAs. You can make conversions year after year if you want to.

In deciding whether to convert an IRA to a Roth IRA or how much to convert, take into account the impact that the conversion may have on the taxation of Social Security benefits. The income from the conversion can trigger or increase the amount of benefits subject to tax, if you make the conversion when you are already receiving Social Security benefits. In deciding how much to convert, make sure you have the funds set aside to pay the taxes (don't use IRA funds for this purpose).

Also take into account the impact of conversion on eligibility for many tax rules and other matters. The conversion income will increase adjusted gross income (AGI), which could prevent you from qualifying for various tax breaks. It also could result in higher Medicare Part B premiums. Planning for AGI is discussed in Chapter 2.

If you convert funds to a Roth IRA in 2010, later on you may wish to undo the action. Perhaps your income in 2011 will be lower than it was in 2010. Or maybe the value of the account will have declined below its value at the time

of conversion. Generally, you have until October 15 of the year following the year of conversion to recharacterize the transaction. This means retitling the Roth IRA as a traditional IRA in order to avoid having the account treated as a taxable distribution.

Example

In March 2010 when the stock market was still low, you thought it was wise to convert your traditional IRA to a Roth IRA. Now, in March 2011, you see that the value of the holdings in your account is even lower than in the previous year. You have until October 15, 2011, to recharacterize the transaction. If you filed your 2010 return before this date, you'll need to file an amended return to delete the conversion income.

Some experts have suggested that separate accounts should be set up for different types of investments, such as large-cap, mid-cap, and small-cap mutual funds or bond funds, made with conversion funds. This would enable you to recharacterize a particular account if it declined in value without having to recharacterize your entire conversion.

IRA Rollovers

You can transfer funds from one IRA to another without any current tax cost. As long as you complete a rollover within 60 days of taking a distribution (you can do this only once a year) or you instruct the trustee or custodian of your current IRA account to transfer the funds directly to the trustee or custodian of a new IRA account (called a direct transfer), there is no current tax on the amount rolled over (you can do this as often as you like).

Rollovers also are allowed from qualified retirement plans to other qualified retirement plans or to IRAs. For example, if you leave your job, you may be able to roll over your 401(k) account to your IRA. If you die and your spouse inherits the benefits, he or she can roll them over to his or her own IRA. This is helpful for younger individuals because it allows spouses to delay starting required minimum distributions until they reach age 70½. But what about benefits inherited by those who are not surviving spouses?

The tax law changed a couple of years ago to allow nonspouses who inherit benefits in qualified retirement plans to make a rollover rather than simply being

taxed immediately on the benefits they inherited. There was, however, confusion about whether plans had to permit the rollover or whether it was discretionary. Under a new law, starting in 2010, plans *must* permit nonspouse beneficiaries to make a direct rollover of inherited benefits (funds are transferred from the qualified plan directly to the rollover account without any check being cut to the nonspouse beneficiary).

PLANNING

If you inherit qualified retirement plan benefits from a person who is not your spouse and you make an IRA rollover, be sure to note how the account must be titled. You must retain the deceased person's name in the title.

Example

An IRA with inherited funds must be titled "Ann Smith, as beneficiary of Betty Smith, deceased" or "Betty Smith, deceased, IRA, for the benefit of daughter Ann Smith, beneficiary."

Roth 401(k) Rollovers

If your employer has a 401(k) plan, a 403(b) plan, or a government 457(b) plan with a Roth component, you can convert a distribution to the Roth account. This rule applies to distributions after September 27, 2010, as long as the plan permits such a rollover. If you make a direct rollover of property (such as stock held in your 401(k) plan) to the Roth account, your income on the conversion is determined by the value of the property on the date of the direct rollover.

PLANNING

For rollovers from these qualified plans to Roth accounts in 2010, the same deferral rule for rollovers to Roth IRAs applies (i.e., half the resulting income is reported in 2011 and half in 2012 unless you opt to report all of the income in 2010). However, as of yet, there is no mechanism to "undo" a rollover to a Roth account as there is in the case of a Roth IRA, as explained earlier. Of course, Congress could change this situation, so check the supplement for any updates.

Elective Deferrals

If you are employed and participate in a 401(k) plan, a 403(b) annuity, a 457 government plan, a salary reduction simplified employee pension (SARSEP) established before 1997, or SIMPLE plan, you can opt to have part of your wages added to the plan. The wages you add to the plan are called elective deferrals or salary reduction contributions. You do not get a tax deduction for your contribution, although you may be eligible for a tax credit related to your contribution, as explained later in this chapter. Instead, the contribution is not included in your income for the year, so you don't pay tax now on your contribution to the plan.

Note: You still pay Social Security and Medicare (FICA) taxes on elective deferrals even though you don't pay federal income tax on them.

Contribution Limits for Plans Other Than SIMPLEs

For 2010, the tax law set the elective deferral limit at $16,500, the same as it was in 2009. This is called the "basic" elective deferral limit.

If you are at least age 50 by December 31, 2010, you can add an additional elective deferral amount, called a "catch-up contribution" for 2010. The catch-up amount for 2010 is $5,500, the same amount as in 2009.

Example

A salaried person age 52 can add $22,000 ($16,500 + $5,500) to a 401(k) plan in 2010 as long as wages are at least $22,000.

Typically, the elective deferral is spread out over the year, with an allocated portion subtracted from each paycheck (or from one paycheck each month for those with a twice-a-month paycheck schedule).

For 2011 and later years, the basic and catch-up contribution amounts can be adjusted upward for inflation. These amounts usually are announced late in the year so plan participants can agree to their contributions for the coming year. With inflation running very low, there may be no increase for 2011.

PLANNING

If you will celebrate your 50th birthday *during* the year, you can make the catch-up contribution *throughout* the year. You don't have to wait until your birthday passes to start making catch-up contributions.

Elective deferrals can be as great as 100 percent of compensation, up to the dollar limit for basic and catch-up contributions for the year. However, most plan participants contribute only a small percentage of their wages. It is highly advisable to contribute at least the minimum amount needed to obtain employer matching contributions. Usually, employer matching contributions are based on up to 6 percent of compensation. However, in these tough economic times, some employers have reduced or eliminated matching contributions, so check with your employer before committing to next year's elective deferral amount.

If you are enrolled in an automatic enrollment plan (one in which your employer enrolls you but you have the ability to opt out or reduce the automatic elective deferral amounts), review your contribution amounts for the coming year. The elective deferral percentage under an automatic enrollment plan can and usually does increase each year. You can choose to increase or decrease this percentage amount. If you have any questions about elective deferrals, ask your plan administrator.

Starting in 2010, small employers (those with 500 or fewer employees) are permitted to offer a hybrid retirement plan that combines a defined benefit (pension) plan with a 401(k) plan. This type of plan is called a DB(k). Since the IRS has not provided guidance on these plans, it is unlikely that employers will offer them for 2010. However, as guidance appears, you may see small employers opting for this plan choice. If your employer adopts this type of plan, ask the plan administrator to explain elective deferral limits and other rules.

Contribution Limits for SIMPLEs

Savings incentive match plans for employees are plans offered by some small employers. From an employee's perspective, they look and act much like a 401(k) plan, although the dollar limits on elective deferrals are lower. For 2010, the elective deferral to a SIMPLE is $11,500, the same as in 2009.

If you are at least age 50 by December 31, 2010, you also can make a catch-up contribution for 2010, unchanged from 2009.

Example

A salaried person age 52 can add $14,000 ($11,500 + $2,500) to a SIMPLE in 2010 as long as compensation for the year is at least $14,000.

PLANNING

Decide on your elective deferral contribution for next year. You can add up to 100 percent of your wages, up to the dollar limit for the basic and catch-up contributions for the year. If your employer makes a *nonelective* contribution (usually 3 percent of your compensation), you receive the benefit of this contribution only if you, too, contribute to the plan for the year.

For 2011 and later years, the basic and catch-up contribution amounts can be adjusted upward for inflation. These amounts usually are announced late in the year so plan participants can decide on their contributions for the coming year. Again, low inflation may mean no increase in the limits for 2011.

Required Minimum Distributions

If you have an IRA or a qualified retirement plan (such as a 401(k) plan), you are required to take annual distributions from the plan starting at age $70^1/_2$. These are called required minimum distributions (RMDs). While the requirement to take RMDs was suspended in 2009 because of the dramatic drop in the stock market in the fall of 2008, the suspension was not extended to 2010.

If you fail to take RMDs, there is a 50 percent penalty. This penalty can be waived only if there was reasonable cause for failing to make a timely RMD.

Who Must Take RMDs and When

If you are the account owner (e.g., you funded your IRA), you must begin to take RMDs no later than April 1 of the year following the year in which you turn age $70^1/_2$. For 2010, this includes those born July 1, 1939, through June 30, 1940. This is so whether or not you are still working. In the case of RMDs from qualified retirement plans (but not from IRAs), you can postpone distributions until you retire as long as you do not own more than 5 percent of the company. There are no lifetime RMDs from Roth IRAs.

If you are a "designated beneficiary" of an IRA (traditional or Roth) or a qualified retirement plan (and you have not rolled over the benefits to another plan or IRA), you must start to take distributions by a certain date that depends on whether the deceased had already been taking distributions:

- If the owner died on or after the required beginning date (April 1 of the year following the year of turning age $70^1/_2$), your RMDs must begin by the end of the year following the year of death.
- If the owner died prior to the required beginning date, you can begin RMDs by the end of the year following the year of death unless you opt for the five-year rule (explained below).

Example

You are the sole designated beneficiary of your mother's IRA with $100,000 in it. She died at age 68 on November 1, 2010. You can start to take distributions over your life expectancy, beginning no later than December 31, 2011. Or, if you opt for the five-year rule, explained later, you can take a distribution of the entire account by December 31, 2016.

A designated beneficiary is someone named by the account owner or designated by the plan as such. An estate or a charity, or a person named by the owner's will, cannot be treated as a designated beneficiary. If the account has more than one designated beneficiary, the oldest one is treated as the designated beneficiary for purposes of figuring RMDs. However, the account can be split among designated beneficiaries as long as this is done by September 30 following the year of death, so each can use his or her own life expectancy. Or one or more beneficiaries can take their distributions immediately or disclaim the inheritance, leaving the balance in the account for a single designated beneficiary. For instance, if the account is left to a brother and a charity, the charity can take its share of the account, leaving the brother as the named beneficiary.

There is a special rule for spouses. A surviving spouse who inherits IRAs or qualified retirement plan benefits can make a tax-free rollover to his/her own account. Distributions from these accounts are then controlled by the surviving spouse. For example, a surviving spouse need not commence RMDs from the rollover account until age $70^1/_2$, regardless of the deceased spouse's age at the time of death. However, if the surviving spouse makes a rollover, funds

in the account cannot be tapped tax free prior to age $59^1/_2$ unless an exception to the early distribution penalty applies to the spouse. A young surviving spouse can, of course, roll over some of the inherited account and commence distributions from the balance, as would any designated beneficiary.

If you are a beneficiary of a Roth IRA, the law prevents you from continuing to build up tax-free income. You must take RMDs, even though the distributions may not be taxable to you.

PLANNING

If you turn age $70^1/_2$ in 2010, you do not have to wait until April 1, 2011, to take your first distribution; you can take it by December 31, 2010. If you delay until April 1, then you'll have to take a second distribution in 2011 (the second RMD must be taken by December 31, 2011). If you turned age $70^1/_2$ in 2009, there was no RMD for that year, but you still must take an RMD by December 31, 2010, to avoid penalties.

Figuring RMDs

RMDs are computed by dividing the balance of the account as of the end of the previous year by a number taken from a specific IRS table. It's as simple as that; for a 2010 RMD, look at the account's balance on December 31, 2009, and divide by the applicable number taken from the tables described below.

Owners should use the Uniform Lifetime Table at the end of this chapter. Owners who have a spouse more than 10 years younger can use their spouse's actual age to figure their RMDs; the Joint Life and Last Survivor Expectancy Table also at the end of this chapter is used for this purpose. However:

- If the owner died on or after the required beginning date (April 1 of the year following the year of turning age $70^1/_2$), your RMDs as a designated beneficiary are payable over your life expectancy (see Single Life Expectancy Table at the end of this chapter). However, if you are older than the owner was at the time of death, you can continue to take RMDs over the owner's remaining life expectancy (as if the owner had not died). These RMDs begin by December 31 of the year following the year of death. Thus, if you inherit your brother's IRA and you are older than your brother, you can base RMDs on your brother's life expectancy remaining at the time of death.
- If the owner died prior to the required beginning date, you can take RMDs over your life expectancy (using the Single Life Expectancy Table at the end

of this chapter) or according to the five-year rule. The five-year rule does not require any distributions for five years. However, the entire account must be distributed no later than five years after the end of the year after death (effectively, nearly six years).

Example

You are married and age 72, and your spouse is 68. The balance in your IRA at the end of 2009 was $100,000. Your 2010 divisor (the figure in the Uniform Lifetime Table) is 25.6. Your RMD for 2010 is $3,906.25 ($100,000 divided by 25.6).

PLANNING

You can take any or all of the funds from your IRA at any time and are not limited to amounts figured for RMDs. You can take funds from qualified retirement plans prior to retirement or leaving the job only if the plans permit it. Usually distributions prior to these events are restricted to hardships, such as imminent foreclosure of your home or pressing medical bills you can't pay from other resources.

In figuring RMDs, you can total the balances of all your IRAs and then take the distribution from one or more of the accounts. For qualified plans, you must take an RMD from each account.

If you take more than the RMD, you don't get "credit" for the excess in a future year (you can't apply it toward a future RMD), other than the extent to which you've reduced the account balance. Each year stands alone in terms of computing your RMD.

Check your beneficiary designation forms to make sure they are up to date, especially following marriage, divorce, births, and deaths. Retain copies (the forms can get lost when financial institutions merge with other firms).

Retirement Savers Credit

A special tax credit, called the Retirement Savings Contributions credit, encourages individuals to fund retirement plans. Low- and moderate-income individuals may be able to double-dip—enjoy a tax benefit from making the contribution (such as a deduction for an IRA contribution or tax deferral on

salary contributed to a 401(k) or SIMPLE plan) as well as claiming a tax credit for the same contribution.

The credit is figured on contributions or elective deferrals up to $2,000. The amount of the credit is your applicable percentage applied to the $2,000 limit—determined by your filing status and adjusted gross income in 2010, as shown in Table 3.3. Thus, the maximum credit is $1,000 (50 percent of $2,000); the minimum credit for anyone eligible to claim a credit is $200 (10 percent of $2,000).

Example

In 2010, you added $2,500 to your employer's 401(k) plan. You are single with adjusted gross income of $20,000 (after the elective deferral). Your credit is $200 (10 percent of $2,000, the limit taken into account in figuring the credit). If your AGI had been no more than $15,000, your credit would have been $1,000; if your AGI had been no more than $16,750, your credit would have been $400. If your AGI had been more than $27,750, you would not have been eligible for any credit.

The contribution amount for purposes of figuring the tax credit is reduced by any distributions you take from a qualified plan that are includible in income during a testing period. The contribution amount also is reduced by any Roth IRA rollover during the testing period that is not a qualified rollover.

The testing period includes the two preceding years, the current year, and the following year through the due date of the return (including extensions). Thus, for purposes of figuring the credit for 2010, consider whether any distributions

TABLE 3.3 Applicable Percentages for the Retirement Savings Contribution Credit in 2010

Adjusted Gross Income						
Joint Filers		Heads of Households		Other Filers		Applicable Percentage
Over	But not over	Over	But not over	Over	But not over	
0	$33,500	0	$25,125	0	$16,750	50%
$33,500	36,000	$25,125	27,000	$16,750	18,000	20
36,000	55,500	27,000	41,625	18,000	27,750	10
55,500	—	41,625	—	27,750	—	0

were taken in 2008, 2009, 2010, and up to April 15, 2011 (assuming no filing extensions are obtained).

PLANNING

Weigh very carefully whether to take withdrawals—for example, IRA withdrawals to pay for the purchase of your first home or to cover medical or educational expenses. Such distributions can be taken without incurring the 10 percent penalty on early withdrawals (see below), but you'll pay ordinary income taxes on the distribution, won't be able to claim the retirement savers credit, and will lose out on tax deferral for earnings that could have been realized on the amount withdrawn.

Tax Penalties on IRAs, 401(k) Plans, and Certain Other Accounts

The tax law can impose an additional tax (called a penalty) for certain actions with respect to these accounts. Acts that are frowned upon and can be subject to an additional tax include making excess contributions (6 percent penalty), withdrawing funds prematurely (10 percent penalty), and failing to take required minimum distributions (50 percent penalty).

Early IRA/401(k) Distributions

The tax law is designed to make sure that money you contribute to an IRA, a 401(k), or other retirement plan stays there and is available for retirement income purposes. However, things come up and you may want or need the money earlier. There are some reasons recognized by the tax law for making withdrawals; these are not subject to an additional tax. However, there are a number of other reasons that are not recognized, and taking money out of your retirement account for one of these purposes could result in a penalty.

Approved reasons for withdrawing funds early. If you take money out for any of the following reasons, there is no additional tax. Note that some penalty exceptions apply only to IRAs and not to 401(k)s or other similar plans.

- You are 59½.
- You are disabled.

- You use the money to pay qualified higher education costs for yourself, your spouse, or a dependent (this applies only to IRAs).
- You pay substantial medical expenses for yourself, your spouse, or a dependent (this applies only to IRAs).
- You pay health insurance and you are unemployed at least 12 consecutive weeks (if self-employed you would have been eligible for unemployment benefits for this period but for the fact that you were not an employee) (this applies only to IRAs).
- You take out funds up to $10,000 to pay first-time, home-buying expenses (this applies only to IRAs).
- You are eligible for a qualified reservist distribution because you are called to active duty in the military.
- You take a distribution of substantially equal periodic payments.
- You leave your job and are at least age 55 (this exception applies only to 401(k)s and other similar plans and not to IRAs).
- You withdraw funds incident to a divorce (this applies only to IRAs).
- Your 401(k) or other qualified retirement plan benefits are paid to a spouse or other alternate payee under the terms of a qualified domestic relations order issued by a court (this applies only to 401(k)s and other similar plans and not to IRAs).
- The IRS imposes levies on your account to cover back taxes (this applies only to IRAs).
- Your company plan closes down and makes a distribution to you (this exception applies only to 401(k)s and other similar plans and not to IRAs).

Reasons for withdrawing funds that could result in a penalty. If you take money out for the following reasons before age $59^1/_2$ and you are not disabled, then the IRS will impose an additional tax because the tax law does not recognize these reasons as an exception to the penalty:

- You have a financial hardship. If you do have a financial hardship, your 401(k) may allow you to take a withdrawal, but it is fully taxable and subject to the 10 percent penalty unless you're at least $59^1/_2$ years old or disabled.
- You use the money to pay down your mortgage.

RMDs

As discussed earlier in this chapter, you must start drawing down retirement accounts at a certain time. If you fail to do this, you are charged with a 50 percent penalty. The penalty is half the amount of the RMD you should have taken but failed to take on time.

PLANNING

If you failed to take an RMD, ask the IRS to forgive the penalty amount. To obtain relief, you must show that the shortfall was due to reasonable cause and that steps are being taken to remedy the shortfall. Complete IRS Form 5329 and attach a letter explaining your reasonable cause and what you're doing to correct the shortfall.

EXHIBIT 3.1 Uniform Lifetime Table

Table III
(Uniform Lifetime)

(For Use by:
- **Unmarried Owners,**
- **Married Owners Whose Spouses Are Not More Than 10 Years Younger, and**
- **Married Owners Whose Spouses Are Not the Sole Beneficiaries of Their IRAs)**

Age	Distribution Period	Age	Distribution Period
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115 and over	1.9

EXHIBIT 3.2 Joint and Last Survivor Expectancy Table

Table II
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	20	21	22	23	24	25	26	27	28	29
20	70.1	69.6	69.1	68.7	68.3	67.9	67.5	67.2	66.9	66.6
21	69.6	69.1	68.6	68.2	67.7	67.3	66.9	66.6	66.2	65.9
22	69.1	68.6	68.1	67.6	67.2	66.7	66.3	65.9	65.6	65.2
23	68.7	68.2	67.6	67.1	66.6	66.2	65.7	65.3	64.9	64.6
24	68.3	67.7	67.2	66.6	66.1	65.6	65.2	64.7	64.3	63.9
25	67.9	67.3	66.7	66.2	65.6	65.1	64.6	64.2	63.7	63.3
26	67.5	66.9	66.3	65.7	65.2	64.6	64.1	63.6	63.2	62.8
27	67.2	66.6	65.9	65.3	64.7	64.2	63.6	63.1	62.7	62.2
28	66.9	66.2	65.6	64.9	64.3	63.7	63.2	62.7	62.1	61.7
29	66.6	65.9	65.2	64.6	63.9	63.3	62.8	62.2	61.7	61.2
30	66.3	65.6	64.9	64.2	63.6	62.9	62.3	61.8	61.2	60.7
31	66.1	65.3	64.6	63.9	63.2	62.6	62.0	61.4	60.8	60.2
32	65.8	65.1	64.3	63.6	62.9	62.2	61.6	61.0	60.4	59.8
33	65.6	64.8	64.1	63.3	62.6	61.9	61.3	60.6	60.0	59.4
34	65.4	64.6	63.8	63.1	62.3	61.6	60.9	60.3	59.6	59.0
35	65.2	64.4	63.6	62.8	62.1	61.4	60.6	59.9	59.3	58.6
36	65.0	64.2	63.4	62.6	61.9	61.1	60.4	59.6	59.0	58.3
37	64.9	64.0	63.2	62.4	61.6	60.9	60.1	59.4	58.7	58.0
38	64.7	63.9	63.0	62.2	61.4	60.6	59.9	59.1	58.4	57.7
39	64.6	63.7	62.9	62.1	61.2	60.4	59.6	58.9	58.1	57.4
40	64.4	63.6	62.7	61.9	61.1	60.2	59.4	58.7	57.9	57.1
41	64.3	63.5	62.6	61.7	60.9	60.1	59.3	58.5	57.7	56.9
42	64.2	63.3	62.5	61.6	60.8	59.9	59.1	58.3	57.5	56.7
43	64.1	63.2	62.4	61.5	60.6	59.8	58.9	58.1	57.3	56.5
44	64.0	63.1	62.2	61.4	60.5	59.6	58.8	57.9	57.1	56.3
45	64.0	63.0	62.2	61.3	60.4	59.5	58.6	57.8	56.9	56.1
46	63.9	63.0	62.1	61.2	60.3	59.4	58.5	57.7	56.8	56.0
47	63.8	62.9	62.0	61.1	60.2	59.3	58.4	57.5	56.7	55.8
48	63.7	62.8	61.9	61.0	60.1	59.2	58.3	57.4	56.5	55.7
49	63.7	62.8	61.8	60.9	60.0	59.1	58.2	57.3	56.4	55.6
50	63.6	62.7	61.8	60.8	59.9	59.0	58.1	57.2	56.3	55.4
51	63.6	62.6	61.7	60.8	59.9	58.9	58.0	57.1	56.2	55.3
52	63.5	62.6	61.7	60.7	59.8	58.9	58.0	57.1	56.1	55.2
53	63.5	62.5	61.6	60.7	59.7	58.8	57.9	57.0	56.1	55.2
54	63.5	62.5	61.6	60.6	59.7	58.8	57.8	56.9	56.0	55.1
55	63.4	62.5	61.5	60.6	59.6	58.7	57.8	56.8	55.9	55.0
56	63.4	62.4	61.5	60.5	59.6	58.7	57.7	56.8	55.9	54.9
57	63.4	62.4	61.5	60.5	59.6	58.6	57.7	56.7	55.8	54.9
58	63.3	62.4	61.4	60.5	59.5	58.6	57.6	56.7	55.8	54.8
59	63.3	62.3	61.4	60.4	59.5	58.5	57.6	56.7	55.7	54.8

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	20	21	22	23	24	25	26	27	28	29
60	63.3	62.3	61.4	60.4	59.5	58.5	57.6	56.6	55.7	54.7
61	63.3	62.3	61.3	60.4	59.4	58.5	57.5	56.6	55.6	54.7
62	63.2	62.3	61.3	60.4	59.4	58.4	57.5	56.5	55.6	54.7
63	63.2	62.3	61.3	60.3	59.4	58.4	57.5	56.5	55.6	54.6
64	63.2	62.2	61.3	60.3	59.4	58.4	57.4	56.5	55.5	54.6
65	63.2	62.2	61.3	60.3	59.3	58.4	57.4	56.5	55.5	54.6
66	63.2	62.2	61.2	60.3	59.3	58.4	57.4	56.4	55.5	54.5
67	63.2	62.2	61.2	60.3	59.3	58.3	57.4	56.4	55.5	54.5
68	63.1	62.2	61.2	60.2	59.3	58.3	57.4	56.4	55.4	54.5
69	63.1	62.2	61.2	60.2	59.3	58.3	57.3	56.4	55.4	54.5
70	63.1	62.2	61.2	60.2	59.3	58.3	57.3	56.4	55.4	54.4
71	63.1	62.1	61.2	60.2	59.2	58.3	57.3	56.4	55.4	54.4
72	63.1	62.1	61.2	60.2	59.2	58.3	57.3	56.3	55.4	54.4
73	63.1	62.1	61.2	60.2	59.2	58.3	57.3	56.3	55.4	54.4
74	63.1	62.1	61.2	60.2	59.2	58.2	57.3	56.3	55.4	54.4
75	63.1	62.1	61.1	60.2	59.2	58.2	57.3	56.3	55.3	54.4
76	63.1	62.1	61.1	60.2	59.2	58.2	57.3	56.3	55.3	54.4
77	63.1	62.1	61.1	60.2	59.2	58.2	57.3	56.3	55.3	54.4
78	63.1	62.1	61.1	60.2	59.2	58.2	57.3	56.3	55.3	54.4
79	63.1	62.1	61.1	60.2	59.2	58.2	57.2	56.3	55.3	54.3
80	63.1	62.1	61.1	60.1	59.2	58.2	57.2	56.3	55.3	54.3
81	63.1	62.1	61.1	60.1	59.2	58.2	57.2	56.3	55.3	54.3
82	63.1	62.1	61.1	60.1	59.2	58.2	57.2	56.3	55.3	54.3
83	63.1	62.1	61.1	60.1	59.2	58.2	57.2	56.3	55.3	54.3
84	63.0	62.1	61.1	60.1	59.2	58.2	57.2	56.3	55.3	54.3
85	63.0	62.1	61.1	60.1	59.2	58.2	57.2	56.3	55.3	54.3
86	63.0	62.1	61.1	60.1	59.2	58.2	57.2	56.2	55.3	54.3
87	63.0	62.1	61.1	60.1	59.2	58.2	57.2	56.2	55.3	54.3
88	63.0	62.1	61.1	60.1	59.2	58.2	57.2	56.2	55.3	54.3
89	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
90	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
91	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
92	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
93	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
94	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
95	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
96	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
97	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
98	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
99	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	20	21	22	23	24	25	26	27	28	29
100	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
101	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
102	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
103	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
104	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
105	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
106	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
107	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
108	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
109	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
110	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
111	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
112	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
113	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
114	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3
115+	63.0	62.1	61.1	60.1	59.1	58.2	57.2	56.2	55.3	54.3

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	30	31	32	33	34	35	36	37	38	39
30	60.2	59.7	59.2	58.8	58.4	58.0	57.6	57.3	57.0	56.7
31	59.7	59.2	58.7	58.2	57.8	57.4	57.0	56.6	56.3	56.0
32	59.2	58.7	58.2	57.7	57.2	56.8	56.4	56.0	55.6	55.3
33	58.8	58.2	57.7	57.2	56.7	56.2	55.8	55.4	55.0	54.7
34	58.4	57.8	57.2	56.7	56.2	55.7	55.3	54.8	54.4	54.0
35	58.0	57.4	56.8	56.2	55.7	55.2	54.7	54.3	53.8	53.4
36	57.6	57.0	56.4	55.8	55.3	54.7	54.2	53.7	53.3	52.8
37	57.3	56.6	56.0	55.4	54.8	54.3	53.7	53.2	52.7	52.3
38	57.0	56.3	55.6	55.0	54.4	53.8	53.3	52.7	52.2	51.7
39	56.7	56.0	55.3	54.7	54.0	53.4	52.8	52.3	51.7	51.2
40	56.4	55.7	55.0	54.3	53.7	53.0	52.4	51.8	51.3	50.8
41	56.1	55.4	54.7	54.0	53.3	52.7	52.0	51.4	50.9	50.3
42	55.9	55.2	54.4	53.7	53.0	52.3	51.7	51.1	50.4	49.9
43	55.7	54.9	54.2	53.4	52.7	52.0	51.3	50.7	50.1	49.5
44	55.5	54.7	53.9	53.2	52.4	51.7	51.0	50.4	49.7	49.1
45	55.3	54.5	53.7	52.9	52.2	51.5	50.7	50.0	49.4	48.7
46	55.1	54.3	53.5	52.7	52.0	51.2	50.5	49.8	49.1	48.4
47	55.0	54.1	53.3	52.5	51.7	51.0	50.2	49.5	48.8	48.1
48	54.8	54.0	53.2	52.3	51.5	50.8	50.0	49.2	48.5	47.8
49	54.7	53.8	53.0	52.2	51.4	50.6	49.8	49.0	48.2	47.5

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	30	31	32	33	34	35	36	37	38	39
50	54.6	53.7	52.9	52.0	51.2	50.4	49.6	48.8	48.0	47.3
51	54.5	53.6	52.7	51.9	51.0	50.2	49.4	48.6	47.8	47.0
52	54.4	53.5	52.6	51.7	50.9	50.0	49.2	48.4	47.6	46.8
53	54.3	53.4	52.5	51.6	50.8	49.9	49.1	48.2	47.4	46.6
54	54.2	53.3	52.4	51.5	50.6	49.8	48.9	48.1	47.2	46.4
55	54.1	53.2	52.3	51.4	50.5	49.7	48.8	47.9	47.1	46.3
56	54.0	53.1	52.2	51.3	50.4	49.5	48.7	47.8	47.0	46.1
57	54.0	53.0	52.1	51.2	50.3	49.4	48.6	47.7	46.8	46.0
58	53.9	53.0	52.1	51.2	50.3	49.4	48.5	47.6	46.7	45.8
59	53.8	52.9	52.0	51.1	50.2	49.3	48.4	47.5	46.6	45.7
60	53.8	52.9	51.9	51.0	50.1	49.2	48.3	47.4	46.5	45.6
61	53.8	52.8	51.9	51.0	50.0	49.1	48.2	47.3	46.4	45.5
62	53.7	52.8	51.8	50.9	50.0	49.1	48.1	47.2	46.3	45.4
63	53.7	52.7	51.8	50.9	49.9	49.0	48.1	47.2	46.3	45.3
64	53.6	52.7	51.8	50.8	49.9	48.9	48.0	47.1	46.2	45.3
65	53.6	52.7	51.7	50.8	49.8	48.9	48.0	47.0	46.1	45.2
66	53.6	52.6	51.7	50.7	49.8	48.9	47.9	47.0	46.1	45.1
67	53.6	52.6	51.7	50.7	49.8	48.8	47.9	46.9	46.0	45.1
68	53.5	52.6	51.6	50.7	49.7	48.8	47.8	46.9	46.0	45.0
69	53.5	52.6	51.6	50.6	49.7	48.7	47.8	46.9	45.9	45.0
70	53.5	52.5	51.6	50.6	49.7	48.7	47.8	46.8	45.9	44.9
71	53.5	52.5	51.6	50.6	49.6	48.7	47.7	46.8	45.9	44.9
72	53.5	52.5	51.5	50.6	49.6	48.7	47.7	46.8	45.8	44.9
73	53.4	52.5	51.5	50.6	49.6	48.6	47.7	46.7	45.8	44.8
74	53.4	52.5	51.5	50.5	49.6	48.6	47.7	46.7	45.8	44.8
75	53.4	52.5	51.5	50.5	49.6	48.6	47.7	46.7	45.7	44.8
76	53.4	52.4	51.5	50.5	49.6	48.6	47.6	46.7	45.7	44.8
77	53.4	52.4	51.5	50.5	49.5	48.6	47.6	46.7	45.7	44.8
78	53.4	52.4	51.5	50.5	49.5	48.6	47.6	46.6	45.7	44.7
79	53.4	52.4	51.5	50.5	49.5	48.6	47.6	46.6	45.7	44.7
80	53.4	52.4	51.4	50.5	49.5	48.5	47.6	46.6	45.7	44.7
81	53.4	52.4	51.4	50.5	49.5	48.5	47.6	46.6	45.7	44.7
82	53.4	52.4	51.4	50.5	49.5	48.5	47.6	46.6	45.6	44.7
83	53.4	52.4	51.4	50.5	49.5	48.5	47.6	46.6	45.6	44.7
84	53.4	52.4	51.4	50.5	49.5	48.5	47.6	46.6	45.6	44.7
85	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.7
86	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
87	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
88	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
89	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	30	31	32	33	34	35	36	37	38	39
90	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
91	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
92	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
93	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
94	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.6	45.6	44.6
95	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
96	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
97	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
98	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
99	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
100	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
101	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
102	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
103	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
104	53.3	52.4	51.4	50.4	49.5	48.5	47.5	46.5	45.6	44.6
105	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
106	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
107	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
108	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
109	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
110	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
111	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
112	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
113	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
114	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6
115+	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6	44.6

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	40	41	42	43	44	45	46	47	48	49
40	50.2	49.8	49.3	48.9	48.5	48.1	47.7	47.4	47.1	46.8
41	49.8	49.3	48.8	48.3	47.9	47.5	47.1	46.7	46.4	46.1
42	49.3	48.8	48.3	47.8	47.3	46.9	46.5	46.1	45.8	45.4
43	48.9	48.3	47.8	47.3	46.8	46.3	45.9	45.5	45.1	44.8
44	48.5	47.9	47.3	46.8	46.3	45.8	45.4	44.9	44.5	44.2
45	48.1	47.5	46.9	46.3	45.8	45.3	44.8	44.4	44.0	43.6
46	47.7	47.1	46.5	45.9	45.4	44.8	44.3	43.9	43.4	43.0
47	47.4	46.7	46.1	45.5	44.9	44.4	43.9	43.4	42.9	42.4
48	47.1	46.4	45.8	45.1	44.5	44.0	43.4	42.9	42.4	41.9
49	46.8	46.1	45.4	44.8	44.2	43.6	43.0	42.4	41.9	41.4

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	40	41	42	43	44	45	46	47	48	49
50	46.5	45.8	45.1	44.4	43.8	43.2	42.6	42.0	41.5	40.9
51	46.3	45.5	44.8	44.1	43.5	42.8	42.2	41.6	41.0	40.5
52	46.0	45.3	44.6	43.8	43.2	42.5	41.8	41.2	40.6	40.1
53	45.8	45.1	44.3	43.6	42.9	42.2	41.5	40.9	40.3	39.7
54	45.6	44.8	44.1	43.3	42.6	41.9	41.2	40.5	39.9	39.3
55	45.5	44.7	43.9	43.1	42.4	41.6	40.9	40.2	39.6	38.9
56	45.3	44.5	43.7	42.9	42.1	41.4	40.7	40.0	39.3	38.6
57	45.1	44.3	43.5	42.7	41.9	41.2	40.4	39.7	39.0	38.3
58	45.0	44.2	43.3	42.5	41.7	40.9	40.2	39.4	38.7	38.0
59	44.9	44.0	43.2	42.4	41.5	40.7	40.0	39.2	38.5	37.8
60	44.7	43.9	43.0	42.2	41.4	40.6	39.8	39.0	38.2	37.5
61	44.6	43.8	42.9	42.1	41.2	40.4	39.6	38.8	38.0	37.3
62	44.5	43.7	42.8	41.9	41.1	40.3	39.4	38.6	37.8	37.1
63	44.5	43.6	42.7	41.8	41.0	40.1	39.3	38.5	37.7	36.9
64	44.4	43.5	42.6	41.7	40.8	40.0	39.2	38.3	37.5	36.7
65	44.3	43.4	42.5	41.6	40.7	39.9	39.0	38.2	37.4	36.6
66	44.2	43.3	42.4	41.5	40.6	39.8	38.9	38.1	37.2	36.4
67	44.2	43.3	42.3	41.4	40.6	39.7	38.8	38.0	37.1	36.3
68	44.1	43.2	42.3	41.4	40.5	39.6	38.7	37.9	37.0	36.2
69	44.1	43.1	42.2	41.3	40.4	39.5	38.6	37.8	36.9	36.0
70	44.0	43.1	42.2	41.3	40.3	39.4	38.6	37.7	36.8	35.9
71	44.0	43.0	42.1	41.2	40.3	39.4	38.5	37.6	36.7	35.9
72	43.9	43.0	42.1	41.1	40.2	39.3	38.4	37.5	36.6	35.8
73	43.9	43.0	42.0	41.1	40.2	39.3	38.4	37.5	36.6	35.7
74	43.9	42.9	42.0	41.1	40.1	39.2	38.3	37.4	36.5	35.6
75	43.8	42.9	42.0	41.0	40.1	39.2	38.3	37.4	36.5	35.6
76	43.8	42.9	41.9	41.0	40.1	39.1	38.2	37.3	36.4	35.5
77	43.8	42.9	41.9	41.0	40.0	39.1	38.2	37.3	36.4	35.5
78	43.8	42.8	41.9	40.9	40.0	39.1	38.2	37.2	36.3	35.4
79	43.8	42.8	41.9	40.9	40.0	39.1	38.1	37.2	36.3	35.4
80	43.7	42.8	41.8	40.9	40.0	39.0	38.1	37.2	36.3	35.4
81	43.7	42.8	41.8	40.9	39.9	39.0	38.1	37.2	36.2	35.3
82	43.7	42.8	41.8	40.9	39.9	39.0	38.1	37.1	36.2	35.3
83	43.7	42.8	41.8	40.9	39.9	39.0	38.0	37.1	36.2	35.3
84	43.7	42.7	41.8	40.8	39.9	39.0	38.0	37.1	36.2	35.3
85	43.7	42.7	41.8	40.8	39.9	38.9	38.0	37.1	36.2	35.2
86	43.7	42.7	41.8	40.8	39.9	38.9	38.0	37.1	36.1	35.2
87	43.7	42.7	41.8	40.8	39.9	38.9	38.0	37.0	36.1	35.2
88	43.7	42.7	41.8	40.8	39.9	38.9	38.0	37.0	36.1	35.2
89	43.7	42.7	41.7	40.8	39.8	38.9	38.0	37.0	36.1	35.2

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	40	41	42	43	44	45	46	47	48	49
90	43.7	42.7	41.7	40.8	39.8	38.9	38.0	37.0	36.1	35.2
91	43.7	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.2
92	43.7	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.1
93	43.7	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.1
94	43.7	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.1
95	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.1
96	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.1
97	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.1	35.1
98	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.0	35.1
99	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.0	35.1
100	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.0	35.1
101	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.0	35.1
102	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.0	35.1
103	43.6	42.7	41.7	40.8	39.8	38.9	37.9	37.0	36.0	35.1
104	43.6	42.7	41.7	40.8	39.8	38.8	37.9	37.0	36.0	35.1
105	43.6	42.7	41.7	40.8	39.8	38.8	37.9	37.0	36.0	35.1
106	43.6	42.7	41.7	40.8	39.8	38.8	37.9	37.0	36.0	35.1
107	43.6	42.7	41.7	40.8	39.8	38.8	37.9	37.0	36.0	35.1
108	43.6	42.7	41.7	40.8	39.8	38.8	37.9	37.0	36.0	35.1
109	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1
110	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1
111	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1
112	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1
113	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1
114	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1
115+	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	35.1

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	50	51	52	53	54	55	56	57	58	59
50	40.4	40.0	39.5	39.1	38.7	38.3	38.0	37.6	37.3	37.1
51	40.0	39.5	39.0	38.5	38.1	37.7	37.4	37.0	36.7	36.4
52	39.5	39.0	38.5	38.0	37.6	37.2	36.8	36.4	36.0	35.7
53	39.1	38.5	38.0	37.5	37.1	36.6	36.2	35.8	35.4	35.1
54	38.7	38.1	37.6	37.1	36.6	36.1	35.7	35.2	34.8	34.5
55	38.3	37.7	37.2	36.6	36.1	35.6	35.1	34.7	34.3	33.9
56	38.0	37.4	36.8	36.2	35.7	35.1	34.7	34.2	33.7	33.3
57	37.6	37.0	36.4	35.8	35.2	34.7	34.2	33.7	33.2	32.8
58	37.3	36.7	36.0	35.4	34.8	34.3	33.7	33.2	32.8	32.3
59	37.1	36.4	35.7	35.1	34.5	33.9	33.3	32.8	32.3	31.8

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	50	51	52	53	54	55	56	57	58	59
60	36.8	36.1	35.4	34.8	34.1	33.5	32.9	32.4	31.9	31.3
61	36.6	35.8	35.1	34.5	33.8	33.2	32.6	32.0	31.4	30.9
62	36.3	35.6	34.9	34.2	33.5	32.9	32.2	31.6	31.1	30.5
63	36.1	35.4	34.6	33.9	33.2	32.6	31.9	31.3	30.7	30.1
64	35.9	35.2	34.4	33.7	33.0	32.3	31.6	31.0	30.4	29.8
65	35.8	35.0	34.2	33.5	32.7	32.0	31.4	30.7	30.0	29.4
66	35.6	34.8	34.0	33.3	32.5	31.8	31.1	30.4	29.8	29.1
67	35.5	34.7	33.9	33.1	32.3	31.6	30.9	30.2	29.5	28.8
68	35.3	34.5	33.7	32.9	32.1	31.4	30.7	29.9	29.2	28.6
69	35.2	34.4	33.6	32.8	32.0	31.2	30.5	29.7	29.0	28.3
70	35.1	34.3	33.4	32.6	31.8	31.1	30.3	29.5	28.8	28.1
71	35.0	34.2	33.3	32.5	31.7	30.9	30.1	29.4	28.6	27.9
72	34.9	34.1	33.2	32.4	31.6	30.8	30.0	29.2	28.4	27.7
73	34.8	34.0	33.1	32.3	31.5	30.6	29.8	29.1	28.3	27.5
74	34.8	33.9	33.0	32.2	31.4	30.5	29.7	28.9	28.1	27.4
75	34.7	33.8	33.0	32.1	31.3	30.4	29.6	28.8	28.0	27.2
76	34.6	33.8	32.9	32.0	31.2	30.3	29.5	28.7	27.9	27.1
77	34.6	33.7	32.8	32.0	31.1	30.3	29.4	28.6	27.8	27.0
78	34.5	33.6	32.8	31.9	31.0	30.2	29.3	28.5	27.7	26.9
79	34.5	33.6	32.7	31.8	31.0	30.1	29.3	28.4	27.6	26.8
80	34.5	33.6	32.7	31.8	30.9	30.1	29.2	28.4	27.5	26.7
81	34.4	33.5	32.6	31.8	30.9	30.0	29.2	28.3	27.5	26.6
82	34.4	33.5	32.6	31.7	30.8	30.0	29.1	28.3	27.4	26.6
83	34.4	33.5	32.6	31.7	30.8	29.9	29.1	28.2	27.4	26.5
84	34.3	33.4	32.5	31.7	30.8	29.9	29.0	28.2	27.3	26.5
85	34.3	33.4	32.5	31.6	30.7	29.9	29.0	28.1	27.3	26.4
86	34.3	33.4	32.5	31.6	30.7	29.8	29.0	28.1	27.2	26.4
87	34.3	33.4	32.5	31.6	30.7	29.8	28.9	28.1	27.2	26.4
88	34.3	33.4	32.5	31.6	30.7	29.8	28.9	28.0	27.2	26.3
89	34.3	33.3	32.4	31.5	30.7	29.8	28.9	28.0	27.2	26.3
90	34.2	33.3	32.4	31.5	30.6	29.8	28.9	28.0	27.1	26.3
91	34.2	33.3	32.4	31.5	30.6	29.7	28.9	28.0	27.1	26.3
92	34.2	33.3	32.4	31.5	30.6	29.7	28.8	28.0	27.1	26.2
93	34.2	33.3	32.4	31.5	30.6	29.7	28.8	28.0	27.1	26.2
94	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.1	26.2
95	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.1	26.2
96	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.2
97	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.2
98	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.2
99	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.2

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	50	51	52	53	54	55	56	57	58	59
100	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.1
101	34.2	33.3	32.4	31.5	30.6	29.7	28.8	27.9	27.0	26.1
102	34.2	33.3	32.4	31.4	30.5	29.7	28.8	27.9	27.0	26.1
103	34.2	33.3	32.4	31.4	30.5	29.7	28.8	27.9	27.0	26.1
104	34.2	33.3	32.4	31.4	30.5	29.6	28.8	27.9	27.0	26.1
105	34.2	33.3	32.3	31.4	30.5	29.6	28.8	27.9	27.0	26.1
106	34.2	33.3	32.3	31.4	30.5	29.6	28.8	27.9	27.0	26.1
107	34.2	33.3	32.3	31.4	30.5	29.6	28.8	27.9	27.0	26.1
108	34.2	33.3	32.3	31.4	30.5	29.6	28.8	27.9	27.0	26.1
109	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1
110	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1
111	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1
112	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1
113	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1
114	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1
115+	34.2	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	60	61	62	63	64	65	66	67	68	69
60	30.9	30.4	30.0	29.6	29.2	28.8	28.5	28.2	27.9	27.6
61	30.4	29.9	29.5	29.0	28.6	28.3	27.9	27.6	27.3	27.0
62	30.0	29.5	29.0	28.5	28.1	27.7	27.3	27.0	26.7	26.4
63	29.6	29.0	28.5	28.1	27.6	27.2	26.8	26.4	26.1	25.7
64	29.2	28.6	28.1	27.6	27.1	26.7	26.3	25.9	25.5	25.2
65	28.8	28.3	27.7	27.2	26.7	26.2	25.8	25.4	25.0	24.6
66	28.5	27.9	27.3	26.8	26.3	25.8	25.3	24.9	24.5	24.1
67	28.2	27.6	27.0	26.4	25.9	25.4	24.9	24.4	24.0	23.6
68	27.9	27.3	26.7	26.1	25.5	25.0	24.5	24.0	23.5	23.1
69	27.6	27.0	26.4	25.7	25.2	24.6	24.1	23.6	23.1	22.6
70	27.4	26.7	26.1	25.4	24.8	24.3	23.7	23.2	22.7	22.2
71	27.2	26.5	25.8	25.2	24.5	23.9	23.4	22.8	22.3	21.8
72	27.0	26.3	25.6	24.9	24.3	23.7	23.1	22.5	22.0	21.4
73	26.8	26.1	25.4	24.7	24.0	23.4	22.8	22.2	21.6	21.1
74	26.6	25.9	25.2	24.5	23.8	23.1	22.5	21.9	21.3	20.8

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	60	61	62	63	64	65	66	67	68	69
75	26.5	25.7	25.0	24.3	23.6	22.9	22.3	21.6	21.0	20.5
76	26.3	25.6	24.8	24.1	23.4	22.7	22.0	21.4	20.8	20.2
77	26.2	25.4	24.7	23.9	23.2	22.5	21.8	21.2	20.6	19.9
78	26.1	25.3	24.6	23.8	23.1	22.4	21.7	21.0	20.3	19.7
79	26.0	25.2	24.4	23.7	22.9	22.2	21.5	20.8	20.1	19.5
80	25.9	25.1	24.3	23.6	22.8	22.1	21.3	20.6	20.0	19.3
81	25.8	25.0	24.2	23.4	22.7	21.9	21.2	20.5	19.8	19.1
82	25.8	24.9	24.1	23.4	22.6	21.8	21.1	20.4	19.7	19.0
83	25.7	24.9	24.1	23.3	22.5	21.7	21.0	20.2	19.5	18.8
84	25.6	24.8	24.0	23.2	22.4	21.6	20.9	20.1	19.4	18.7
85	25.6	24.8	23.9	23.1	22.3	21.6	20.8	20.1	19.3	18.6
86	25.5	24.7	23.9	23.1	22.3	21.5	20.7	20.0	19.2	18.5
87	25.5	24.7	23.8	23.0	22.2	21.4	20.7	19.9	19.2	18.4
88	25.5	24.6	23.8	23.0	22.2	21.4	20.6	19.8	19.1	18.3
89	25.4	24.6	23.8	22.9	22.1	21.3	20.5	19.8	19.0	18.3
90	25.4	24.6	23.7	22.9	22.1	21.3	20.5	19.7	19.0	18.2
91	25.4	24.5	23.7	22.9	22.1	21.3	20.5	19.7	18.9	18.2
92	25.4	24.5	23.7	22.9	22.0	21.2	20.4	19.6	18.9	18.1
93	25.4	24.5	23.7	22.8	22.0	21.2	20.4	19.6	18.8	18.1
94	25.3	24.5	23.6	22.8	22.0	21.2	20.4	19.6	18.8	18.0
95	25.3	24.5	23.6	22.8	22.0	21.1	20.3	19.6	18.8	18.0
96	25.3	24.5	23.6	22.8	21.9	21.1	20.3	19.5	18.8	18.0
97	25.3	24.5	23.6	22.8	21.9	21.1	20.3	19.5	18.7	18.0
98	25.3	24.4	23.6	22.8	21.9	21.1	20.3	19.5	18.7	17.9
99	25.3	24.4	23.6	22.7	21.9	21.1	20.3	19.5	18.7	17.9
100	25.3	24.4	23.6	22.7	21.9	21.1	20.3	19.5	18.7	17.9
101	25.3	24.4	23.6	22.7	21.9	21.1	20.2	19.4	18.7	17.9
102	25.3	24.4	23.6	22.7	21.9	21.1	20.2	19.4	18.6	17.9
103	25.3	24.4	23.6	22.7	21.9	21.0	20.2	19.4	18.6	17.9
104	25.3	24.4	23.5	22.7	21.9	21.0	20.2	19.4	18.6	17.8
105	25.3	24.4	23.5	22.7	21.9	21.0	20.2	19.4	18.6	17.8
106	25.3	24.4	23.5	22.7	21.9	21.0	20.2	19.4	18.6	17.8
107	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
108	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
109	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
110	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
111	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
112	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
113	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
114	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8
115+	25.2	24.4	23.5	22.7	21.8	21.0	20.2	19.4	18.6	17.8

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	70	71	72	73	74	75	76	77	78	79
70	21.8	21.3	20.9	20.6	20.2	19.9	19.6	19.4	19.1	18.9
71	21.3	20.9	20.5	20.1	19.7	19.4	19.1	18.8	18.5	18.3
72	20.9	20.5	20.0	19.6	19.3	18.9	18.6	18.3	18.0	17.7
73	20.6	20.1	19.6	19.2	18.8	18.4	18.1	17.8	17.5	17.2
74	20.2	19.7	19.3	18.8	18.4	18.0	17.6	17.3	17.0	16.7
75	19.9	19.4	18.9	18.4	18.0	17.6	17.2	16.8	16.5	16.2
76	19.6	19.1	18.6	18.1	17.6	17.2	16.8	16.4	16.0	15.7
77	19.4	18.8	18.3	17.8	17.3	16.8	16.4	16.0	15.6	15.3
78	19.1	18.5	18.0	17.5	17.0	16.5	16.0	15.6	15.2	14.9
79	18.9	18.3	17.7	17.2	16.7	16.2	15.7	15.3	14.9	14.5
80	18.7	18.1	17.5	16.9	16.4	15.9	15.4	15.0	14.5	14.1
81	18.5	17.9	17.3	16.7	16.2	15.6	15.1	14.7	14.2	13.8
82	18.3	17.7	17.1	16.5	15.9	15.4	14.9	14.4	13.9	13.5
83	18.2	17.5	16.9	16.3	15.7	15.2	14.7	14.2	13.7	13.2
84	18.0	17.4	16.7	16.1	15.5	15.0	14.4	13.9	13.4	13.0
85	17.9	17.3	16.6	16.0	15.4	14.8	14.3	13.7	13.2	12.8
86	17.8	17.1	16.5	15.8	15.2	14.6	14.1	13.5	13.0	12.5
87	17.7	17.0	16.4	15.7	15.1	14.5	13.9	13.4	12.9	12.4
88	17.6	16.9	16.3	15.6	15.0	14.4	13.8	13.2	12.7	12.2
89	17.6	16.9	16.2	15.5	14.9	14.3	13.7	13.1	12.6	12.0
90	17.5	16.8	16.1	15.4	14.8	14.2	13.6	13.0	12.4	11.9
91	17.4	16.7	16.0	15.4	14.7	14.1	13.5	12.9	12.3	11.8
92	17.4	16.7	16.0	15.3	14.6	14.0	13.4	12.8	12.2	11.7
93	17.3	16.6	15.9	15.2	14.6	13.9	13.3	12.7	12.1	11.6
94	17.3	16.6	15.9	15.2	14.5	13.9	13.2	12.6	12.0	11.5
95	17.3	16.5	15.8	15.1	14.5	13.8	13.2	12.6	12.0	11.4
96	17.2	16.5	15.8	15.1	14.4	13.8	13.1	12.5	11.9	11.3
97	17.2	16.5	15.8	15.1	14.4	13.7	13.1	12.5	11.9	11.3
98	17.2	16.4	15.7	15.0	14.3	13.7	13.0	12.4	11.8	11.2
99	17.2	16.4	15.7	15.0	14.3	13.6	13.0	12.4	11.8	11.2
100	17.1	16.4	15.7	15.0	14.3	13.6	12.9	12.3	11.7	11.1
101	17.1	16.4	15.6	14.9	14.2	13.6	12.9	12.3	11.7	11.1
102	17.1	16.4	15.6	14.9	14.2	13.5	12.9	12.2	11.6	11.0
103	17.1	16.3	15.6	14.9	14.2	13.5	12.9	12.2	11.6	11.0
104	17.1	16.3	15.6	14.9	14.2	13.5	12.8	12.2	11.6	11.0
105	17.1	16.3	15.6	14.9	14.2	13.5	12.8	12.2	11.5	10.9
106	17.1	16.3	15.6	14.8	14.1	13.5	12.8	12.2	11.5	10.9
107	17.0	16.3	15.6	14.8	14.1	13.4	12.8	12.1	11.5	10.9
108	17.0	16.3	15.5	14.8	14.1	13.4	12.8	12.1	11.5	10.9
109	17.0	16.3	15.5	14.8	14.1	13.4	12.8	12.1	11.5	10.9

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	70	71	72	73	74	75	76	77	78	79
110	17.0	16.3	15.5	14.8	14.1	13.4	12.7	12.1	11.5	10.9
111	17.0	16.3	15.5	14.8	14.1	13.4	12.7	12.1	11.5	10.8
112	17.0	16.3	15.5	14.8	14.1	13.4	12.7	12.1	11.5	10.8
113	17.0	16.3	15.5	14.8	14.1	13.4	12.7	12.1	11.4	10.8
114	17.0	16.3	15.5	14.8	14.1	13.4	12.7	12.1	11.4	10.8
115+	17.0	16.3	15.5	14.8	14.1	13.4	12.7	12.1	11.4	10.8

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	80	81	82	83	84	85	86	87	88	89
80	13.8	13.4	13.1	12.8	12.6	12.3	12.1	11.9	11.7	11.5
81	13.4	13.1	12.7	12.4	12.2	11.9	11.7	11.4	11.3	11.1
82	13.1	12.7	12.4	12.1	11.8	11.5	11.3	11.0	10.8	10.6
83	12.8	12.4	12.1	11.7	11.4	11.1	10.9	10.6	10.4	10.2
84	12.6	12.2	11.8	11.4	11.1	10.8	10.5	10.3	10.1	9.9
85	12.3	11.9	11.5	11.1	10.8	10.5	10.2	9.9	9.7	9.5
86	12.1	11.7	11.3	10.9	10.5	10.2	9.9	9.6	9.4	9.2
87	11.9	11.4	11.0	10.6	10.3	9.9	9.6	9.4	9.1	8.9
88	11.7	11.3	10.8	10.4	10.1	9.7	9.4	9.1	8.8	8.6
89	11.5	11.1	10.6	10.2	9.9	9.5	9.2	8.9	8.6	8.3
90	11.4	10.9	10.5	10.1	9.7	9.3	9.0	8.6	8.3	8.1
91	11.3	10.8	10.3	9.9	9.5	9.1	8.8	8.4	8.1	7.9
92	11.2	10.7	10.2	9.8	9.3	9.0	8.6	8.3	8.0	7.7
93	11.1	10.6	10.1	9.6	9.2	8.8	8.5	8.1	7.8	7.5
94	11.0	10.5	10.0	9.5	9.1	8.7	8.3	8.0	7.6	7.3
95	10.9	10.4	9.9	9.4	9.0	8.6	8.2	7.8	7.5	7.2
96	10.8	10.3	9.8	9.3	8.9	8.5	8.1	7.7	7.4	7.1
97	10.7	10.2	9.7	9.2	8.8	8.4	8.0	7.6	7.3	6.9
98	10.7	10.1	9.6	9.2	8.7	8.3	7.9	7.5	7.1	6.8
99	10.6	10.1	9.6	9.1	8.6	8.2	7.8	7.4	7.0	6.7
100	10.6	10.0	9.5	9.0	8.5	8.1	7.7	7.3	6.9	6.6
101	10.5	10.0	9.4	9.0	8.5	8.0	7.6	7.2	6.9	6.5
102	10.5	9.9	9.4	8.9	8.4	8.0	7.5	7.1	6.8	6.4
103	10.4	9.9	9.4	8.8	8.4	7.9	7.5	7.1	6.7	6.3
104	10.4	9.8	9.3	8.8	8.3	7.9	7.4	7.0	6.6	6.3
105	10.4	9.8	9.3	8.8	8.3	7.8	7.4	7.0	6.6	6.2
106	10.3	9.8	9.2	8.7	8.2	7.8	7.3	6.9	6.5	6.2
107	10.3	9.8	9.2	8.7	8.2	7.7	7.3	6.9	6.5	6.1
108	10.3	9.7	9.2	8.7	8.2	7.7	7.3	6.8	6.4	6.1
109	10.3	9.7	9.2	8.7	8.2	7.7	7.2	6.8	6.4	6.0

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	80	81	82	83	84	85	86	87	88	89
110	10.3	9.7	9.2	8.6	8.1	7.7	7.2	6.8	6.4	6.0
111	10.3	9.7	9.1	8.6	8.1	7.6	7.2	6.8	6.3	6.0
112	10.2	9.7	9.1	8.6	8.1	7.6	7.2	6.7	6.3	5.9
113	10.2	9.7	9.1	8.6	8.1	7.6	7.2	6.7	6.3	5.9
114	10.2	9.7	9.1	8.6	8.1	7.6	7.1	6.7	6.3	5.9
115+	10.2	9.7	9.1	8.6	8.1	7.6	7.1	6.7	6.3	5.9

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	90	91	92	93	94	95	96	97	98	99
90	7.8	7.6	7.4	7.2	7.1	6.9	6.8	6.6	6.5	6.4
91	7.6	7.4	7.2	7.0	6.8	6.7	6.5	6.4	6.3	6.1
92	7.4	7.2	7.0	6.8	6.6	6.4	6.3	6.1	6.0	5.9
93	7.2	7.0	6.8	6.6	6.4	6.2	6.1	5.9	5.8	5.6
94	7.1	6.8	6.6	6.4	6.2	6.0	5.9	5.7	5.6	5.4
95	6.9	6.7	6.4	6.2	6.0	5.8	5.7	5.5	5.4	5.2
96	6.8	6.5	6.3	6.1	5.9	5.7	5.5	5.3	5.2	5.0
97	6.6	6.4	6.1	5.9	5.7	5.5	5.3	5.2	5.0	4.9
98	6.5	6.3	6.0	5.8	5.6	5.4	5.2	5.0	4.8	4.7
99	6.4	6.1	5.9	5.6	5.4	5.2	5.0	4.9	4.7	4.5
100	6.3	6.0	5.8	5.5	5.3	5.1	4.9	4.7	4.5	4.4
101	6.2	5.9	5.6	5.4	5.2	5.0	4.8	4.6	4.4	4.2
102	6.1	5.8	5.5	5.3	5.1	4.8	4.6	4.4	4.3	4.1
103	6.0	5.7	5.4	5.2	5.0	4.7	4.5	4.3	4.1	4.0
104	5.9	5.6	5.4	5.1	4.9	4.6	4.4	4.2	4.0	3.8
105	5.9	5.6	5.3	5.0	4.8	4.5	4.3	4.1	3.9	3.7
106	5.8	5.5	5.2	4.9	4.7	4.5	4.2	4.0	3.8	3.6
107	5.8	5.4	5.1	4.9	4.6	4.4	4.2	3.9	3.7	3.5
108	5.7	5.4	5.1	4.8	4.6	4.3	4.1	3.9	3.7	3.5
109	5.7	5.3	5.0	4.8	4.5	4.3	4.0	3.8	3.6	3.4
110	5.6	5.3	5.0	4.7	4.5	4.2	4.0	3.8	3.5	3.3
111	5.6	5.3	5.0	4.7	4.4	4.2	3.9	3.7	3.5	3.3
112	5.6	5.3	4.9	4.7	4.4	4.1	3.9	3.7	3.5	3.2
113	5.6	5.2	4.9	4.6	4.4	4.1	3.9	3.6	3.4	3.2
114	5.6	5.2	4.9	4.6	4.3	4.1	3.9	3.6	3.4	3.2
115+	5.5	5.2	4.9	4.6	4.3	4.1	3.8	3.6	3.4	3.1

EXHIBIT 3.2 (*Continued*)

Table II (continued)
(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	100	101	102	103	104	105	106	107	108	109
100	4.2	4.1	3.9	3.8	3.7	3.5	3.4	3.3	3.3	3.2
101	4.1	3.9	3.7	3.6	3.5	3.4	3.2	3.1	3.1	3.0
102	3.9	3.7	3.6	3.4	3.3	3.2	3.1	3.0	2.9	2.8
103	3.8	3.6	3.4	3.3	3.2	3.0	2.9	2.8	2.7	2.6
104	3.7	3.5	3.3	3.2	3.0	2.9	2.7	2.6	2.5	2.4
105	3.5	3.4	3.2	3.0	2.9	2.7	2.6	2.5	2.4	2.3
106	3.4	3.2	3.1	2.9	2.7	2.6	2.4	2.3	2.2	2.1
107	3.3	3.1	3.0	2.8	2.6	2.5	2.3	2.2	2.1	2.0
108	3.3	3.1	2.9	2.7	2.5	2.4	2.2	2.1	1.9	1.8
109	3.2	3.0	2.8	2.6	2.4	2.3	2.1	2.0	1.8	1.7
110	3.1	2.9	2.7	2.5	2.3	2.2	2.0	1.9	1.7	1.6
111	3.1	2.9	2.7	2.5	2.3	2.1	1.9	1.8	1.6	1.5
112	3.0	2.8	2.6	2.4	2.2	2.0	1.9	1.7	1.5	1.4
113	3.0	2.8	2.6	2.4	2.2	2.0	1.8	1.6	1.5	1.3
114	3.0	2.7	2.5	2.3	2.1	1.9	1.8	1.6	1.4	1.3
115+	2.9	2.7	2.5	2.3	2.1	1.9	1.7	1.5	1.4	1.2

(Joint Life and Last Survivor Expectancy)
(For Use by Owners Whose Spouses Are More Than 10 Years Younger and Are the Sole Beneficiaries of Their IRAs)

Ages	110	111	112	113	114	115+
110	1.5	1.4	1.3	1.2	1.1	1.1
111	1.4	1.2	1.1	1.1	1.0	1.0
112	1.3	1.1	1.0	1.0	1.0	1.0
113	1.2	1.1	1.0	1.0	1.0	1.0
114	1.1	1.0	1.0	1.0	1.0	1.0
115+	1.1	1.0	1.0	1.0	1.0	1.0

EXHIBIT 3.3 Single Life Expectancy Table

Table I
(Single Life Expectancy)
(For Use by Beneficiaries)

Age	Life Expectancy	Age	Life Expectancy
56	28.7	84	8.1
57	27.9	85	7.6
58	27.0	86	7.1
59	26.1	87	6.7
60	25.2	88	6.3
61	24.4	89	5.9
62	23.5	90	5.5
63	22.7	91	5.2
64	21.8	92	4.9
65	21.0	93	4.6
66	20.2	94	4.3
67	19.4	95	4.1
68	18.6	96	3.8
69	17.8	97	3.6
70	17.0	98	3.4
71	16.3	99	3.1
72	15.5	100	2.9
73	14.8	101	2.7
74	14.1	102	2.5
75	13.4	103	2.3
76	12.7	104	2.1
77	12.1	105	1.9
78	11.4	106	1.7
79	10.8	107	1.5
80	10.2	108	1.4
81	9.7	109	1.2
82	9.1	110	1.1
83	8.6	111 and over	1.0

CHAPTER 4

New Investment Opportunities and Traps

While the stock market and the housing market have shown some improvement during 2010, both are still a long way from their highs just a few short years ago. Still, you may be buying and/or selling securities and other investments. How does the tax law impact you and what changes are afoot?

This chapter covers what you need to know about tax rules for investment actions for 2010. It also explains expected tax changes for 2011 and later years that can impact your investment decisions now and for years to come.

Build America Bonds

Build America Bonds (BABs), created by the American Recovery and Reinvestment Act, are *taxable* municipal bonds issued by states and municipalities for schools and infrastructure. What sets them apart from other bonds is the fact that the federal government effectively pays 35 percent of the bond interest. Typically, the issuer retains this federal subsidy and offers a higher rate of interest on the bond. The issuer is allowed to pass the 35 percent interest credit on to the investor; if the credit cannot be fully utilized by the investor in one year, it can be carried over to the next. These bonds can be issued only in 2009 and 2010.

Alert

The federal subsidy may be extended beyond 2010, although it may be at a reduced rate from the subsidy in 2009 and 2010; check the Supplement for details.

From your perspective as an investor, these bonds offer a relatively high yield and safety (the bonds are AAA-rated). However, the bonds are *not* guaranteed by the federal government even though there is the interest subsidy, so an investor still needs to exercise caution in buying a BAB.

PLANNING

Because BAB interest is taxable, the bonds probably are best held in an IRA so that the interest becomes tax deferred.

Interest on Savings Bonds

With so much uncertainty in the stock market, many people look for safety of their principal, and what better place to loot than to the U.S. Treasury. The Treasury issues U.S. savings bonds, Series EE and I, which are backed by the full faith and credit of the U.S. government. Interest on savings bonds is usually taxable (although it is always exempt from state income taxes). It can escape tax when bonds are redeemed to pay certain higher education costs (see Chapter 2). Or you can postpone the tax on interest, as explained here.

You can opt to report interest annually, but this is rarely done. Typically, bondholders wait to report the interest until they redeem the bonds or the bonds mature. At that time, a part of what you receive represents principal (what you paid for the bonds) and the balance is interest.

For Series EE bonds purchased after May 2005, the interest rate between May 1, 2010, and November 1, 2010, was 1.40 percent. For Series I bonds purchased in this period, the interest rate paid during this period was 1.97 percent (0.20 percent fixed rate plus 1.77 percent variable rate). You can learn more about U.S. savings bonds at TreasuryDirect (www.treasurydirect.gov).

If you already own bonds and want to transfer them to a revocable trust (often referred to as a *living trust*), you can do so without triggering immediate taxation. Title to the bonds is transferred to the trust, and the interest continues

to be taxable to you when and to the extent described above as long as you are treated as the owner of the trust.

You can purchase Series I U.S. savings bonds using your tax return. You can apply up to $5,000 of a tax refund toward the purchase of bonds in denominations of $50. The purchase is made through a Treasury Direct account. You provide account information to the IRS on your tax return and the purchase is made automatically.

Tax on Qualified Dividends

For qualified dividends, the same tax rules that applied in 2008 and 2009 continue to apply in 2010. This means that qualified dividends are taxed at 15 percent for taxpayers in tax brackets above 15 percent. There is no tax on qualified dividends for taxpayers in the 10 percent or 15 percent tax brackets. For 2010, the 15 percent tax bracket covers taxable income up to $68,000 for joint filers, $45,550 for heads of households, and $34,000 for singles. (Taxable income is income after subtracting deductions and exemptions.)

How do you know whether the dividends you received qualify for this special tax treatment? On Form 1099-DIV, *Dividends and Distributions*, which you receive early in the year following the year of dividend payments, qualified dividends are identified in Box 1b.

Alert

After 2010, dividends are scheduled to be taxed the same as ordinary income, such as bank account interest. However, Congress may extend or modify the current special tax treatment for dividends; check the Supplement for details.

PLANNING

You are taxed on dividends even if you reinvest them to buy more stock or mutual fund shares. However, do not forget to add these dividends to your cost basis of the stock or mutual fund shares so that you minimize gain (or optimize loss) when you later sell your holdings.

Keeping track of your basis in stock and mutual fund shares should become easier. Beginning in 2011 for stocks, 2012 for mutual funds and dividend reinvestment plans, and 2013 for any other covered securities (such as options),

brokerage firms and other investment institutions are required to report basis information (including reinvested dividends) to you.

General Capital Gain Rates

During the stock market downturn, people have been focused more on their losses than on their gains. However, some people have continued to enjoy capital gains on the sale of stocks, bonds, mutual fund shares, and other capital gain property. The tax law continues to provide favorable treatment for capital gains. Technically a capital gain for this purpose means a net long-term capital gain in excess of any net short-term capital loss. Long-term capital gains and losses result from sales or exchanges after holding the assets for more than one year. Capital gain distributions from mutual funds are taxed like long-term capital gains.

The maximum tax rate on most capital gains continues for 2010 to be 15 percent. For taxpayers in the 10 percent or 15 percent tax brackets, there is *no* tax on capital gains. The taxable income limits for the 15 percent tax bracket are listed the preceding section, "Tax on Qualified Dividends."

Alert

After 2010, old capital gain rates are set to apply. This means that sales of stock, for example, in 2011 will be taxed at 20 percent rather than the 15 percent rate applicable in 2010; for taxpayers in the 10 percent and 15 percent tax brackets, the zero tax will no longer apply. However, Congress could extend the favorable capital gain rates, at least for some taxpayers; check the Supplement for details.

The amount of capital gains representing depreciation recapture is taxed at 25 percent for taxpayers in tax brackets of 25 percent or higher. Capital gains on the sale or exchange of collectibles and certain small business stock are taxed at 28 percent for taxpayers in tax brackets of 28 percent or higher.

PLANNING

Since taxpayers in the 10 percent or 15 percent tax brackets pay no tax on capital gains, it may be helpful to give appreciated securities to an elderly parent whom

you are already helping to support. The parent can sell the securities and pay no capital gains, allowing more money to be retained within the family.

Example

You are helping to support your elderly mother and usually give her $750 a month in cash. You own 100 shares of XYZ stock now worth $9,000, which cost you $3,000 to acquire. If you sell the stock, you'll have only $8,100 after tax (your $6,000 gain [$9,000 – $3,000] incurs tax of $900 [$6,000 × 15 percent]). If you give your mother the shares and she sells them, she can use the entire proceeds, $9,000, in place of your monthly $750 for an entire year!

Because of the scheduled rise in the top tax capital gain rate, there are some planning tips to keep in mind.

If you are selling property on an installment basis in 2010 where some or all of the payments will be received after 2010, it may be advisable *not* to use installment reporting for the transaction. Installment reporting means that gain is recognized as payments are received. However, with the hike in the capital gain rate, deferral will make the gain taxable at higher rates than the rate for 2010. Consider electing out of installment reporting for 2010 installment sales by including all of the gain on your 2010 return.

The same theory applies to like-kind exchanges, which allow you to defer tax on gain until a future date. Like-kind exchanges involve trades of certain investment property; the gain is not recognized until the property acquired in the trade is sold. It may make sense to *not* make a like-kind exchange (which automatically means deferral) so that gain can be recognized now. For example, simply sell for cash to gain is recognized and then use the proceeds to purchase like-kind property.

Small Business Stock

Usually, gain on the sale of stock held for more than one year is taxed at a capital gain rate of no more than 15 percent. However, there is a special rule for stock that is qualifying small business stock. Gain on the sale of qualifying small business stock (defined shortly) held at least five years is not fully taxed.

Instead, a portion of the gain can be excluded from income; the balance is subject to tax at a rate of up to 28 percent.

For some time now the exclusion for gain on qualifying small business stock has been 50 percent. There also has been a 60 percent exclusion for small business stock in a business within an empowerment zone (an economically disadvantaged area designated by the federal government) if the stock is acquired after December 31, 2000, and before January 1, 2014. Now a higher exclusion is possible. For stock issued by any "qualified small business" after February 17, 2009, and before September 28, 2010, the exclusion is increased to 75 percent. For stock issued after September 27, 2010, and before January 1, 2011, the exclusion is increased to 100 percent (i.e., no portion of the gain on such stock held at least five years will be taxable).

Qualified small business stock is stock in a C corporation (not an S corporation) acquired in the original issue for money or property other than stock, or as compensation for services other than underwriting the stock offering.

PLANNING

Obviously, because of the five-year holding period, the higher exclusion won't come into play for a number of years. However, action now can ensure that you acquire stock within the applicable time frame. For instance, employees holding stock options may want to exercise them before January 1, 2011, so that they'll be able to qualify for a 100 percent exclusion.

If, after 2009, you sell small business stock that had been in an empowerment zone. The stock was issued before February 18, 2009, and you can disregard the end of the empowerment zone designation on December 31, 2009, so that you still qualify for the 60 percent exclusion.

Using the exclusion for small business stock sales for regular tax purposes requires an adjustment for alternative minimum tax (AMT) purposes. The portion of the gain from the sale of this small business stock that is excludable from income for regular tax purposes is includible in alternative minimum taxable income. For instance, if the 50 percent exclusion applies, then seven percent of the exclusion becomes a tax preference for the AMT.

Mark-to-Market Reporting

Those who regularly trade in securities may make a tax election, called mark-to-market accounting, to treat all securities positions as having been sold at the end of the year for their fair market value, with all gains and losses deemed to be ordinary gains or losses. Thus, those who incur losses would be able to report them all as ordinary losses rather than as capital losses subject to limitations.

However, the time limit for making a mark-to-market election is limited. The election for a tax year must be made no later than the due date of the return for the prior tax year. For example, a mark-to-market election for 2011 has to be made by April 15, 2011 (the due date for the 2010 return). A timely election applies to the year for which it is made and all later years unless the IRS grants permission to revoke the election.

As recent court decisions have demonstrated, the election cannot be made retroactively and no extension can be granted to make a late election. Thus, the election cannot be made on an amended return (which, by definition, is filed after the due date of the return for the year in question).

Investment Losses in Ponzi Schemes

The Bernard Madoff Ponzi scheme and other similar financial frauds in 2008 left thousands of investors without their money and with uncertainty about how to handle their losses for tax purposes. Unfortunately for investors, more financial schemes are being uncovered every day. The IRS has created a safe harbor for affected investors under which they can treat losses as a theft loss and claim a deduction. The safe harbor avoids problems of proof of how much income reported in prior years was fictitious or a return of capital.

Who qualifies? The safe harbor can be used only by an investor in a taxable account if the lead figure, such as Bernard Madoff, has been charged federally or under state law with fraud, embezzlement, or a similar crime and the investor invested solely with such lead figure (and not through a fund or other entity). The safe harbor does *not* apply to investments made through tax-deferred accounts, such as IRAs.

What to deduct? Under the safe harbor, an investor can deduct 95 percent of the "qualified investment" if he or she isn't pursuing any third-party recovery, or 75 percent if pursuing or intending to pursue a third-party recovery. The qualified investment is the sum of cash and the basis of property invested in the arrangement over the years, plus income (even so-called phantom income) derived from the arrangement that was included for federal tax purposes in the investor's income, minus any cash or property withdrawn by the investor from the arrangement. After applying the 95 percent or 75 percent, the deductible amount is then reduced by any actual or potential insurance or Securities Investor Protection Corporation (SIPC) recovery.

When to claim the deduction? Eligible investors can claim this safe-harbor deduction in the year of discovery, which is usually the year in which the lead figure has been indicted. Attach to the return for the year of discovery a form created by the IRS (see Exhibit 4.1).

Also, since the loss is treated as a theft loss, Form 4684, *Casualties and Thefts,* must be used to report the theft loss. Enter the "deductible theft loss" on line 34 of Form 4684 (mark "Revenue Procedure 2009-20" across the top of the form).

PLANNING

Since the loss can give rise to a net operating loss, amounts that can't be used in the current year can be carried back to offset income in prior years. For losses discovered in 2010 and later years, the carryback period is two years (unless Congress makes it longer).

Losses in Passive Activities

As a way to clamp down on so-called tax shelters, the tax law limits losses from activities treated as passive activities (all rental realty as well as other businesses in which you do not materially participate) to the amount of income from such activities for the year. If losses cannot be claimed currently under this rule, the excess can be carried forward and used to offset passive activity income in future years. If you dispose of an investment in a passive activity, you can then

APPENDIX A

Statement by Taxpayer Using the Procedures in Rev. Proc. 2009-20 to Determine a Theft Loss Deduction Related to a Fraudulent Investment Arrangement

Part 1. Identification

1. Name of Taxpayer ____

2. Taxpayer Identification Number _________________________________

Part II. Computation of deduction

(See Rev. Proc. 2009-20 for the definitions of the terms used in this worksheet.)

Line	Computation of Deductible Theft Loss Pursuant to Rev. Proc. 2009-20		
1	Initial investment		
2	Plus: Subsequent investments		
3	Plus: Income reported in prior years		
4	Less: Withdrawals	( )	
5	Total qualified investment (combine lines 1 through 4)		
6	Percentage of qualified investment (95% of line 5 for investors with no potential third-party recovery; 75% of line 5 for investors with potential third-party recovery)		
7	Actual recovery		
8	Potential insurance/SIPC recovery		
9	Total recoveries (add lines 7 and 8)		( )
10	Deductible theft loss (line 6 minus line 9)		

Part III. Required statements and declarations

1. I am claiming a theft loss deduction pursuant to Rev. Proc. 2009-20 from a specified fraudulent arrangement conducted by the following individual or entity (provide the name, address, and taxpayer identification number [if known]).

____

2 I have written documentation to support the amounts reported in Part II of this document.

3. I am a qualified investor as defined in § 4.03 of Rev. Proc. 2009-20.

4. If I have determined the amount of my theft loss deduction under § 5.02(1)(a) of Rev. Proc. 2009-20, I declare that I have not pursued and do not intend to pursue any potential third-party recovery, as that term is defined in § 4.10 of Rev. Proc. 2009-20.

EXHIBIT 4.1 Taxpayer Statement for Revenue Procedure 2009-20

5. If I have already filed a return or amended return that does not satisfy the conditions in § 6.02 of Rev. Proc 2009-20, I agree to all adjustments or actions that are necessary to comply with those conditions. The tax year or years for which I filed the return(s) or amended return(s) and the date(s) on which they were filed are as follows:

____

____

____

____

____

Part IV. Signature

I make the following agreements and declarations:

1. I agree to comply with the conditions and agreements set forth in Rev. Proc. 2009-20 and this document.

2. Under penalties of perjury, I declare that the information provided in Parts I-III of this document is, to the best of my knowledge and belief, true, correct, and complete.

Your signature here __________________________ Date signed: _______
Your spouse's signature here ______________________ Date signed: ______

Corporate Name _________________________________
Corporate Officer's signature ____________________________
Title ____________________________

Date signed ________

Entity Name ____
S-corporation, Partnership, Limited Liability Company, Trust

Entity Officer's signature ______________________________________

Date signed ___________

Signature of executor ____
Date signed ____

EXHIBIT 4.1 (*Continued*)

report all of the carried-over losses from such activity without regard to passive activity income that year. These are called the passive activity loss (PAL) rules.

If you are a limited partner in a business, you are automatically treated as owning an interest in a passive activity. However, courts in 2009 concluded (despite IRS objections) that investments in limited liability companies (LLCs) or limited liability partnerships (LLPs) are not *automatically* treated as passive activities. Even though owners in LLCs and LLPs have personal liability protection, they can participate in the operations of the business and may materially participate so as to avoid the passive activity loss limits.

The IRS has now acquiesced to the court decisions, even though it still has objections to the reasoning. Thus, LLC members can try to demonstrate their participation in a passive activity in order to avoid the PAL limitations.

PLANNING

Once an LLC member proves material participation, it means that income from the activity becomes subject to self-employment tax. Don't forget to take this into account in tax planning (including estimated tax payments).

Reporting Foreign Accounts

As a U.S. citizen or resident, if you own or have an interest in a foreign financial account, you are taxed on the income from the account. Because foreign institutions are not required to report income as are domestic financial institutions, which report interest, dividends, and so on, on Form 1099, investors are required under the Bank Secrecy Act to disclose their holdings to the IRS if the value of all foreign accounts exceeds $10,000 at any time during the year. Disclosure is required regardless of the amount of income, if any, that these accounts produce. Those who are required to file but don't, may be subject to a penalty of up to $10,000.

Usually reporting is done by filing Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (affectionately called FBAR), by June 30 of the year following the year to which the reporting applies (e.g., the form for 2010 accounts is due by June 30, 2011). Obtaining a filing extension for your personal income tax return does not give you more time to file this form. In fact, there is no extension possible for this form, and penalties apply if you fail to file and the IRS discovers it.

How will the IRS learn of foreign accounts? In 2009, it conducted a voluntary disclosure program under which taxpayers could come forward to disclose their secret foreign accounts without penalty. At the same time, the IRS began to pressure certain foreign financial institutions, such as UBS, to provide lists of its depositors and a number of them have already complied.

Form TD F 90-22.1 is not filed with the IRS; it is filed with the Treasury Department. Mail it to the U.S. Department of the Treasury, P.O. Box 32621, Detroit, MI 48232-0621 (if you use a private delivery service such as FedEx, send it to the IRS Enterprise Computing Center, Attn: CTR Operations Mailroom, 4th floor, 985 Michigan Avenue, Detroit, MI 48226).

Alert

The IRS has created a draft of a revised Form TD F 90-22.1 that likely will be used for 2010 reporting in 2011. Some of the rules for reporting on the draft form have changed from the current version; check the Supplement to learn whether a final version of the form has been released.

Underpayment Penalty

If a taxpayer has an underpayment resulting from a transaction involving an undisclosed foreign asset, the underpayment penalty is doubled to 40 percent (the penalty usually is 20 percent). This increased penalty applies to tax years after March 18, 2010 (i.e., 2011 for most individuals).

Example

You did not file Form TD F 90-22.1 as required for a bank account. If the IRS finds that there has been a substantial understatement of tax or negligence in reporting interest, dividends, or other income from the foreign account, the underpayment penalty that normally would be 20 percent for such errors is doubled to 40 percent.

Partial Annuitization of Commercial Annuities

If you bought an annuity policy from an insurance company (not through a qualified retirement plan or IRA), usually you must annuitize (meaning

receive monthly benefits) on an all-or-nothing basis. Under new law effective for amounts received after 2010, you can make a partial annuitization. This allows the balance of the annuity to continue to grow.

The only requirement for partial annuitization: The annuity period must be for 10 years or more, or for the lives of one or more individuals.

Amounts received under this partial annuitization rule are taxed under the same rules for complete annuitization. The investment in the contract, a figure used in determining the taxable portion of each payment received, is allocated on a pro rata basis between the portion of the policy annuitized and the portion that is not annuitized. If you annuitize before age 59-1/2 and are not disabled, the taxable portion of each payment is subject to the 10 percent early distribution penalty; the new law permitting partial annuitization did not change the penalty rule.

Additional Medicare Tax on Investments

Starting in 2013, there is an additional 3.8 percent Medicare tax imposed on the lesser of net investment income or modified adjusted gross income (MAGI) over $200,000 for singles, $250,000 for joint filers (regardless of who owns the investments), or $125,000 for married persons filing separately.

Net investment income is the total of all types of investment income and gains minus deductions allocable to these gains.

- *Examples of investment income include* interest, dividends, annuities, royalties and rents (unless derived from a business), income from passive activities, and gains attributable to the sale of property (other than business property).
- *Examples of income not treated as investment income include* interest on tax-exempt bonds, veterans' benefits, the gain excluded on the sale of a principal residence, IRA and 401(k) distributions, and pensions.

Starting in 2013, to avoid estimated tax penalties, you will have to adjust wage withholding or increase estimated tax payments to cover the additional Medicare tax if you think you will be subject to it.

PLANNING

While the new tax does not take effect for a couple of years, it is not too soon to start planning ahead. Review investment holdings to make adjustments where appropriate. Here are some tips to consider:

- If you are planning to sell a principal residence and the gain will exceed your exclusion amount ($250,000 for singles; $500,000 for joint filers), consider closing the sale before 2013. In this way, the excess gain will escape the 3.8 percent Medicare tax.
- When comparing the after-tax yield on taxable bonds with tax-exempt bonds, take into account the additional 3.8 percent Medicare tax that will apply to taxable bonds if you expect to have MAGI over the threshold for the additional Medicare tax.

CHAPTER 5

New Ways to Boost Your Take-Home Pay

If you have a job, tax rules can help improve your paycheck. Some breaks run only for 2010, while others may continue into the future.

This chapter explains other key breaks impacting employees. It also covers some special rules for those who have lost jobs.

Making Work Pay Credit

There is a new tax credit for 2009 and 2010 called the Making Work Pay credit. It has been the cornerstone of the Obama administration's recovery package, costing about one-third of the total of all the tax breaks in the American Recovery and Reinvestment Act of 2009.

The credit is 6.2 percent of earned income, up to a maximum of $400 for singles and $800 for joint filers per year.

Eligibility

The credit can be claimed only by those with earned income (wages or self-employment income). Earned income for purposes of this credit includes tax-free combat pay. Those who receive only investment income, alimony, or other unearned income cannot claim the credit.

Certain taxpayers cannot claim the credit, even if they have earned income:

- Anyone who can be claimed as another person's dependent.
- Trusts and estates.
- Nonresident aliens.

Payment Method

The credit may not be new to you; if you had a job in 2009 you are already acquainted with it. Your take-home pay for last year and 2010 reflects the Making Work Pay credit and you don't have to take any action to receive it in your paycheck.

For self-employed individuals, receipt of the credit is a different matter. Because self-employed individuals do not receive a paycheck (regardless of the fact that they may take withdrawals from their company's bank account), they cannot enjoy the credit through increased take-home pay. Instead, self-employed individuals have two ways of receiving the credit:

1. Reduce estimated taxes for the year to reflect the credit amount they expect to be entitled to.
2. Claim the credit on the tax return when it is filed. For example, the Making Work Pay credit for 2010 can be claimed on the 2010 return when it is filed in 2011.

Schedule M

The credit is figured on Schedule M, *Making Work Pay Credit,* which is part of Form 1040 or 1040A. The form is used to ensure that you obtain the full amount of the credit you're entitled to.

Example

You were unemployed from the start of 2010 until September 2010. Your modified adjusted gross income (MAGI) for the year is below the limit. Your paychecks for 2010 did not advance the full amount of the credit to you. Using Schedule M will let you figure the shortfall so you effectively can claim the balance of the credit on your tax return.

TABLE 5.1 MAGI Phaseout Ranges for the Making Work Pay Credit

Filing Status	Phaseout Range
Married filing jointly	$150,000 to $190,000
Other taxpayers	$75,000 to $95,000

MAGI Cap

The credit is allowed only if modified adjusted gross income (MAGI) is below a set amount. MAGI for this purpose means adjusted gross income (AGI) without regard to the exclusions for foreign earned income and housing, so anyone who does not work outside the United States can base their income limit on AGI. Once MAGI exceeds an initial threshold, the credit is phased out at a rate of 2 percent. Table 5.1 shows the phaseout ranges for the Making Work Pay credit for 2010; the ranges are unchanged from 2009.

Example

In 2010, you are a head of household with modified adjusted gross income of $60,000 (as a head of household, you are subject to the MAGI limits for singles). Because your MAGI is below the phaseout range, you are entitled to the full $400 credit. If your MAGI were $85,000, your credit would be limited to $200. Once your MAGI exceeds $95,000, no credit is allowed.

The Making Work Pay credit is figured on Schedule M if you file Form 1040 or 1040A; a special worksheet for figuring the credit is used by Form 1040EZ filers. Even though the credit effectively has been paid via an increase in take-home pay, the amounts received in this manner may be more or less than the credit amount you're entitled to so everyone potentially entitled to a credit (i.e., anyone who works and is not someone else's dependent or a nonresident alien) must complete Schedule M (or the worksheet for Form 1040EZ). Income limitations explained earlier may mean you aren't entitled to the credit even though your employer paid it out to you through an increase in your take-home pay. Examples of individuals who may have received too much via the credit include:

- Dependents who work.
- Married couples where one or both work for more than one employer.
- Singles who work for more than one employer.

PLANNING

On 2009 returns, the IRS waived any underpayment penalty resulting from the Making Work Pay credit. Whether there will be a similar waiver for 2010 is not certain, so it is advisable to avoid underpayments. Employees who may be underwithheld because of the Making Work Pay credit should adjust their withholding allowances before the end of 2010. This is done by filing a new Form W-4 with your employer. You can direct that the employer reduce the number of allowances so that your withholding increases and your take-home pay is reduced, or you can ask the employer to withhold a fixed amount from your wages to cover what you expect will be your tax shortfall.

Transportation Fringe Benefits

Usually, your out-of-pocket costs for commuting to and from work each day are not deductible; they are considered nondeductible personal expenses. There are, however, ways around this rule. Your employer can pay for certain transportation fringe benefits up to set limits and you are *not* taxed on the payments made on your behalf. The monthly benefits include:

- *Free parking*—parking spaces for employees on or near the employer's business premises or at or near a location from which the employees commute to work by mass transit, car pooling, or van pooling, such as a train or bus station.
- *Monthly transit passes*—payments for mass transit travel to and from work.
- *Van pooling*—a program that the employer sets up for transporting employees to and from work in a company-owned "commuter highway vehicle" that seats at least six adults (not counting the driver) and for which at least 80 percent of the mileage is used to transport the employees to and from work.

For 2010, the dollar limit on the exclusion for all of these types of transportation benefits is $230 per month. The benefits are in parity for this year. However, after 2010, parity ends unless Congress extends it, so that new figures will be provided for free parking, monthly transit passes, and van pooling.

For 2010, there is an additional transportation fringe benefit for bicycle commuting, something valued by employees in bicycle-friendly cities such as

Denver, CO, New York City, and Portland, OR. An employee can receive from an employer $20 per month tax free (the same amount as in 2009) to cover the cost of buying, storing, and maintaining a bicycle used to get to and from work. To receive this fringe benefit, an employee cannot receive free parking, commuter passes, or van pooling.

Alert

Whether the bicycle fringe benefit will be extended beyond 2010 remains to be seen. Check the Supplement for details.

PLANNING

Your employer may allow you to pay for monthly transit passes on a pretax basis. Like contributions to 401(k) plans, the amount of your wages that you opt to apply toward the purchase of monthly transit passes is not treated as taxable wages (the amount is subtracted from your wages). The elective deferral that reduces your wages cannot exceed the dollar limit for transit passes for the year.

You can enjoy *both* free parking and monthly transit passes or van pooling, for a maximum monthly exclusion in 2010 of $460. For example, if your employer pays for parking at the train station and transit passes for the train, you can exclude the cost of each up to $230 a month for parking and $230 a month for the train travel.

Foreign Earned Income Exclusion

If you work abroad, you may still owe U.S. income taxes. The tax law generally requires U.S. citizens and residents to file U.S. income tax returns and pay U.S. income taxes on their worldwide income. However, the law allows you to exclude income earned outside of the United States from income on a U.S. tax return up to a set limit. For 2010, the limit is $91,500; in 2009, it was $91,400.

To qualify for this exclusion, you must meet one of two tests:

- A foreign residence test—you are a U.S. citizen and you reside abroad.
- A foreign physical presence test of 330 days—you are a U.S. citizen or resident living in a foreign country for an uninterrupted period that includes one full year.

Only compensation paid by a private employer (and/or self-employment income) earned in a foreign country qualifies for the exclusion. U.S. government pay does not qualify for the exclusion, regardless of the fact that you live abroad. The exclusion does not apply to those who work in locations that are not foreign countries:

- Antarctica
- International airspace
- International waters

PLANNING

The exclusion amount can be adjusted annually for inflation, so it may be higher in 2011.

Foreign income taxes paid on foreign wages or self-employment income can be claimed as a tax deduction or credit on a U.S. income tax return.

If your wages are subject to Social Security taxes in a foreign country, you may escape double tax if your employer informs the IRS of this situation (self-employed individuals must pay self-employment tax on all of their foreign earned income, including any excludable amount).

Housing Expenses

If you are living abroad and qualify for the foreign earned income exclusion, you also can exclude housing expenses over a set amount. For 2010, the base housing amount has increased to $40.07 a day, or $14,624 for the entire year; expenses over this amount are excludable. However, the excludable amount cannot exceed 30 percent of the foreign earned income exclusion of $91,500, or $27,450 in 2010. Higher dollar limits apply in certain so-called high-cost areas, such as Athens, Beijing, Buenos Aires, Geneva, London, Madrid, Melbourne, Moscow, and Tokyo.

PLANNING

The exclusion amount can be adjusted annually for inflation, so it may be higher in 2011.

You can find a complete list of the higher dollar limits on housing in high-cost areas in the official IRS instructions to Form 2555, *Foreign Earned Income.*

FICA

Social Security and Medicare taxes collectively are referred to as FICA. The employer and employee each pay a like amount on compensation for the year. The tax rates on the Social Security and Medicare portions of FICA tax for employers and employees remain unchanged for 2010. The Social Security tax rate is 6.2 percent and the basic Medicare tax rate is 1.45 percent. These basic rates remain the same year after year.

The wage base limit on which the Social Security portion of the tax is figured is limited to $106,800 in 2010, the same as it was in 2009. There is no wage base limit for the Medicare portion of the tax.

Example

In 2010, you receive a salary of $110,000 from X Corp. You pay $6,622 in Social Security tax ($106,800 × 6.2 percent) and $1,595 in Medicare tax ($110,000 × 1.45 percent) for a total FICA payment of $8,217. (Your employer pays the same amount.)

PLANNING

While the official wage base for 2011 was not available at the time of publication, it is expected to remain unchanged from the 2010 limit of $106,800. Check the Supplement for any update.

Credit for Excess Social Security Tax Withheld

If you work for more than one employer and earn a certain amount, you may find at the end of the year that you've paid more in Social Security (and Tier 1 Railroad Retirement) tax than you were required to. As mentioned earlier, for 2010, the maximum Social Security tax is 6.2 percent of wages up to

$106,800, the same as it was in 2009, or $6,622. If you paid more than this limit, you treat the excess as a credit toward your tax payment when you file your return.

Example

In 2010, you worked for two employers. Your wages from one employer were $75,000 and wages from the other employer were $50,000 (total wages for the year were $125,000). You paid Social Security tax of $7,750, so you can claim $1,128 ($7,750 – $6,622) as a credit on your return (it counts as additional taxes you've paid).

The credit is claimed on your return by reducing the taxes you owe for the year.

Because there is no wage base limit for the Medicare tax portion of FICA, you cannot claim any credit with respect to withholding for Medicare taxes.

Additional Medicare Tax

Starting in 2013, there is an additional Medicare tax of 0.9 percent on the wages of certain high-income taxpayers. The additional tax is imposed on wages in excess of $200,000 for singles, $250,000 for joint filers, and $125,000 for married persons filing separately. The additional tax also is imposed on net earned from self-employment (discussed in Chapter 7).

Usually, the Medicare tax is levied on each worker separately. However, the additional Medicare tax is imposed on the combined wages of a married couple filing jointly.

There is another additional Medicare tax on investment income. This additional tax is explained in Chapter 4.

Paying the Additional Tax

The basic Medicare tax is withheld from an employee's paycheck. For the additional Medicare tax, the employer is required to withhold it only if an employee's wages exceed $200,000. The employer does not have to inquire about a spouse's wages.

Example

In 2013, you are single and work for Company X and earn $175,000. You also have a sideline business that nets you $100,000 for the year. Your employer is not obligated to withhold the additional Medicare tax on your wages because they do not exceed $200,000.

If you are subject to the additional Medicare tax because your combined earnings from more than one job and/or self-employment exceed the threshold for your filing status and the additional tax has not been withheld on your behalf, you are responsible for payment of the additional tax. You are liable for this additional tax even if your employer was supposed to withhold it but failed to do so. Contrast this to the basic Medicare tax, where an employee is not liable for the tax if the employer fails to withhold it.

PLANNING

If you have to pay the additional Medicare tax, be sure to take it into account in figuring wage withholding or estimated tax payments so you avoid estimated tax penalties.

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. The basic rules for the earned income credit, including new developments for 2010 and what may happen in 2011, is explained in Chapter 1.

Advanced Credit

For 2010, if you expect to qualify for the earned income credit and have at least one qualifying child, you could have received the credit on an advanced basis. Your paycheck would have been increased to the extent of the credit. You had to file Form W-5, *Earned Income Credit Advance Payment Certificate*, with your employer to receive it.

For 2011, the advanced earned income credit is no longer available; it has been repealed.

Unemployment Benefits

Generally, all unemployment benefits paid by states to individuals who are terminated from their jobs are included income. For 2009, a recipient was able to exclude up to $2,400 of such benefits from income. This exclusion applied without regard to overall income for 2009. However, for 2010, *all* unemployment benefits are includible in gross income.

PLANNING

Recipients of unemployment benefits can opt to have income taxes withheld from their benefits by filing Form W-4V, *Voluntary Withholding*. If this is done, withholding is taken at the rate of 10 percent. For certain individuals, voluntary withholding can avoid the need to pay estimated taxes.

Most states also have voluntary withholding of state income tax on unemployment benefits. For example, in Illinois, voluntary withholding is at the rate of 3 percent of benefits; in Massachusetts, it's 5.3 percent of benefits; in New York, it's 2.5 percent of benefits.

COBRA Subsidy

If you lost your job prior to June 1, 2010, you may be eligible for continuing health coverage under COBRA (an acronym for the Consolidated Omnibus Budget Reconciliation Act), a federal law requiring employers that regularly employ at least 20 workers and that offer health coverage to allow workers who leave the job to continue in the plan. Usually, the former employee must pay all of the premiums, but under a special subsidy, the federal government pays 65 percent of premiums for up to 15 months for certain eligible individuals.

Example

On March 31, 2010, you are laid off from your job and opt to continue in the company's health plan through COBRA. The federal government will pay 65 percent of your premiums from April 2010 through June 2011; you pay the other 35 percent. You can continue the coverage through September 2011, but you'll have to pay 100 percent of the premiums.

Whether the federal subsidy is taxable and other rules about the COBRA subsidy are explained in Chapter 2.

Educator Deduction

If you are a teacher, principal, aide, or counselor in primary or secondary school and work at least 900 hours, in 2009 you were able to deduct up to $250 of your out-of-pocket costs for classroom supplies as an adjustment to gross income.

Alert

This deduction may be extended for 2010; check the Supplement for details.

Even if the deduction is extended, it does not apply to parents who home-school their children.

PLANNING

If you are an educator who may qualify for this deduction, be sure to save receipts to back up the write-off in case your return is questioned.

If the deduction is not extended for 2010 (or it is extended but your out-of-pocket costs exceed $250), you can deduct classroom expenses as an unreimbursed employee business expense. This is first entered on Form 2106, *Employee Business Expenses,* and then deducted as a miscellaneous itemized deduction. Only miscellaneous itemized expenses in excess of 2 percent of adjusted gross income are actually deductible. And, if you are subject to the alternative minimum tax (explained in Chapter 6), you lose the benefit of this deduction entirely.

CHAPTER 6

Other Money-Saving Tax Breaks

There are numerous tax breaks that don't fit neatly into other chapters. These include deductions for nonitemizers, various itemized deductions, and other specific write-offs.

In reviewing the income exclusions, tax deductions, and credits contained in this chapter, be sure to note both time limits and income limits on eligibility.

This chapter explains not only an array of tax breaks that you can use to reduce your tax bill; it also includes an explanation of the alternative minimum tax. Finally, it includes general tax-planning strategies for income and deductions.

Standard Deduction

More than 60 percent of taxpayers do not itemize their deductions. Instead, they claim a standard deduction, which is an amount fixed annually; the deduction depends on your filing status.

The standard deduction can be claimed by any taxpayer, with two exceptions. The standard deduction *cannot* be claimed by:

- A dependent of another taxpayer.
- A spouse who files separately if the other spouse itemizes his or her deductions. This spouse must itemize, too.

TABLE 6.1 Basic Standard Deduction Amounts

Filing Status	2010	2009
Married filing jointly	$11,400	$11,400
Head of household	8,400	8,350
Single	5,700	5,700
Married filing separately	5,700	5,700

The basic standard deduction amounts can be increased annually for inflation, although with modest inflation at this time, only one filing status—head of household—was adjusted slightly for 2010. In Table 6.1 you'll find the basic standard deduction amounts for 2010 as well as amounts for the prior year.

Additional Standard Deduction Amounts

Even though you don't itemize, you may be able to increase your basic standard deduction amount because of certain things. These additional amounts include write-offs for:

- Age and/or blindness
- Real property taxes
- Net disaster losses

Alert

The additional deductions for real property taxes and for net disaster losses expired at the end of 2009 but could be extended for 2010; check the Supplement for details.

If you have an additional standard deduction (other than for age and/or blindness), you must complete Schedule L, *Standard Deduction for Certain Filers.*

Age and/or Blindness

If you are age 65 or older and/or legally blind, you can add to the standard deduction the following:

- Unmarried: Add $1,400 in 2010 (the same as in 2009).
- Married filing jointly: Each spouse can add $1,100 (the same as in 2009).

You are not limited to a single additional amount. If you meet both the age and blindness tests, then you can double the additional amounts. If both spouses are at least 65 years old, again, two additional amounts can be claimed.

Example

In 2010, you are 72 and your spouse is 68. You can increase your standard deduction of $11,400 by $2,200 ($1,100 + $1,100). Your total standard deduction is $13,600 ($11,400 + $2,200).

PLANNING

If you were born on January 1, you are deemed to be age 65 on the previous December 31. For example, if you were born on January 1, 1946, you are treated as being age 65 in 2010 and can use the additional standard deduction amount.

The additional standard deduction amounts can be increased for inflation in future years.

Real Estate Taxes

Usually, local property taxes on your home, vacation home, or other personally held realty are claimed as itemized deductions. However, you may be able to choose to deduct up to $500 if single, or $1,000 if a joint filer, as an additional standard deduction amount.

Alert

Again, this additional standard deduction for real estate taxes expired at the end of 2009 but could be extended for 2010; check the Supplement for details.

PLANNING

Even if the additional standard deduction for real estate taxes is extended, if your taxes are substantial, it probably makes more sense to itemize your tax

deductions. In this case, you could deduct *all* of the property taxes (not just the $500/$1,000 amount allowed as an additional standard deduction amount).

Losses in Federal Disaster Areas

If you suffered a loss in an area declared eligible for federal disaster relief, you may be able to add your casualty loss deduction to your standard deduction rather than claiming it as an itemized deduction. The rules for figuring losses in federal disaster areas are explained later in this chapter.

Alert

Again, this additional standard deduction for net disaster losses expired at the end of 2009 but could be extended for 2010; check the Supplement for details.

Itemized Deductions

Itemized deductions are simply a listing of personal deductions that the tax law lets you write off. The deductions are reported on Schedule A of Form 1040 (you can't use Form 1040A or 1040EZ if you want to itemize your deductions).

Average Itemized Deductions

If you are concerned or curious about what the average medical expense or charitable contribution deduction is, you can find this information in Table 6.2; it shows average itemized deductions for 2008 (the most recent year for statistics) based on adjusted gross income.

TABLE 6.2 Average Itemized Deductions for 2008

AGI (thousands)	Medical	Taxes	Interest	Charitable
15 – <30	$ 7,074	$ 3,146	$ 9,245	$ 2,024
30 – <50	6,153	3,830	9,055	2,189
50 – <100	7,102	6,050	10,659	2,693
100 – <200	9,269	10,798	13,734	3,757
200 – <250	21,554	18,164	18,570	5,895
250 and over	37,143	50,267	27,865	20,930

The average deduction amounts are just that, an average. Yours may be higher or lower. Some experts believe that IRS computers flag returns containing deductions that exceed these averages. If you are entitled to a deduction and have the paperwork to back it up, you should take the write-off.

Reduction for High-Income Taxpayers

Before 2010, there had been a reduction in the amount of itemized deductions you could claim if you were a high-income taxpayer. The phaseout, however, does not apply for 2010.

Alert

A limitation on high-income taxpayers is scheduled to reapply starting in 2011 unless Congress prevents this from happening.

Medical Deductions

Itemized medical deductions are discussed in Chapter 2.

Charitable Contributions

If you itemize deductions, you may be able to write off your cash and property donations to your favorite charities. The basic rules for charitable contributions haven't changed for 2010 and are unlikely to change dramatically in the future.

Haitian Relief Donations

If you made cash donations to an IRS-approved organization providing relief to victims of the Haitian earthquake disaster after January 11, 2010, and before March 1, 2010, you were permitted to deduct the donations on your 2009 return. If you did, then no additional write-off for the same donations is allowed on your 2010 return. If you did not take the deduction on your 2009 return, then be sure to claim it on your 2010 return.

If you made donations of marketable securities or other property during this period, you can deduct them on your 2010 return to the extent otherwise allowed.

IRA Transfers

Those age 70½ and older can transfer up to $100,000 from their IRA directly to a public charity and avoid taxation on the withdrawal. The donation isn't tax deductible, but the withdrawal is tax free.

Alert

This break expired at the end of 2009 but could be extended for 2010; check the Supplement for details.

PLANNING

Charitable donations require substantiations. For cash donations of any amount, you need a bank record or an acknowledgment from the charity showing the amount of the donation. For cash donations of $250 or more, you *must* have an acknowledgment from the charity; a canceled check won't do. For property donations, appraisals may be required.

You can't deduct donations you make directly to needy individuals, no matter how worthy they are or how generous you are.

You can't deduct the value of your time doing volunteer work. You can, however, write off your out-of-pocket expenses on behalf of the charity. For example, in 2010 you can deduct the cost of driving to do charity work at the rate of 14 cents per mile. This rate has not changed from 2009, although there have been proposals in Congress to up the mileage rate; nothing yet has been enacted.

Easements

Donations of certain easements let you have your cake and eat it too. You can continue to enjoy your property while obtaining a current deduction for the donation of a conservation easement or a façade easement to charity.

A conservation easement is a permanent restriction on the use of land for certain purposes, such as preserving open spaces, wetlands, or endangered species. Usually, a deduction for a property donation is capped at 30 percent of your adjusted gross income for the year in which the donation is made (unused amounts can be carried forward for up to five years). However, for donations

in 2006 through 2009, donations of conservation easements had a 50 percent cap; unused amounts could be carried forward for up to 15 years. Farmers and ranchers had a 100 percent cap of donations of property used for agriculture or livestock production.

Alert

The increased conservation easement caps and carryovers may be extended for 2010; check the Supplement for details.

In a case involving a conservation easement, the Tax Court refused to allow a deduction for a donation of "air rights" or "unused development rights" related to a historic apartment building in New York City. Despite the proximity of the air rights to the building, the language of conservation easement in this case did not cover the additional rights.

A façade easement is a permanent historic preservation program to keep the exterior of a building intact. The special rules applicable to conservation easements do not apply to façade easements.

In one case, the Tax Court allowed a deduction for a conservation easement related to two buildings in Washington, DC. The covenant creating the façade easement clearly restricted changes to the buildings, and bronze plaques affixed to the buildings proclaimed the easements. The only question before the court was the amount by which the easements reduced the value of the property, which is the measurement of the charitable contribution; the court arrived at an amount lower than claimed by the taxpayers but higher than that suggested by the IRS (zero).

The Tax Court also decided in another case that no deduction for a façade easement can be claimed when the property it relates to is subject to a mortgage. The existence of a mortgage prevents the certainty that the façade will be preserved because the lender can obtain ownership of the property if there is a foreclosure. The fact that the owner is unlikely to default is irrelevant.

Casualty and Theft Losses

If you itemize your deductions, you can write-off losses after reducing each casualty or theft event by $100 (it had been $500 in 2009 and Congress may retain the higher limit) and total losses by 10 percent of adjusted gross income.

Home Damage from Imported Drywall

Certain imported drywall (much of which comes from China and is referred to as Chinese drywall) has caused blackening or corrosion of electrical wiring and copper components in household appliances, as well as sulfur gas odors in homes in numerous states. In 2009, the Consumer Product Safety Commission determined that the imported drywall caused the damage and odor. Now the IRS has recognizes that the damage to the homes from the installation of the imported drywall is a casualty that may be tax deductible.

When is the tax loss? Homeowners who repair the damage to their homes and/or household appliances can treat the cost as a casualty loss in the year of payment. Those who have already made repairs and filed returns for prior years have three years in which to file amended returns to claim a tax refund.

What is the tax loss? The amount of the deduction depends on whether a homeowner is still seeking reimbursement from insurance or pursuing litigation.

- If there is no pending claim, then all unreimbursed costs for repairs are the amounts used to figure the casualty loss. If, for example, the repairs were made in 2009, then the loss (the repair costs) has to be reduced by $500.
- If there is a pending claim, under an IRS safe harbor, a homeowner can treat 75 percent of the cost of repair as the amount used to compute the casualty loss in the year of payment. The homeowner does not have to wait to resolve the pending claim before claiming some tax relief.

Which drywall qualifies? There is a two-step identification method published by the Consumer Protection Safety Commission and the Department of Housing and Urban Development found at HYPERLINK "http://www.cpsc.gov/info/drywall/InterimIDGuidance012810.pdf" www.cpsc.gov/info/drywall/InterimIDGuidance012810.pdf.

Damages

Generally, all damages received are fully taxable *except* for compensatory damages for physical injury or sickness. It is often problematic to decide when emotional distress, and the compensation for it, is excludable as payment for a physical injury or taxable as a nonphysical injury.

The Tax Court has reiterated that in discrimination actions that do not involve physical injury or sickness, the exclusion covers damages for emotional distress only to the extent the amounts are expended for medical care attributable to emotional distress. The fact that there is an allegation of physical injury is not sufficient; the settlement or award allocated to emotional distress must clearly connect the emotional distress to a physical injury.

This past year, there have been various cases and rulings on whether damages are tax free or taxable.

- The portion of damages for wrongful termination that related to the worsening of an employee's multiple sclerosis was ruled to be tax free.
- Damages for false imprisonment without any showing of physical injury were ruled to be taxable.

Alimony

Alimony usually is deductible by the spouse making the payments and taxable to the spouse receiving the payments. The basic rules for alimony, child support, and property settlements have not changed for 2010; there are no proposed changes for coming years.

Property Settlements

Usually, property settlements incident to divorce are not taxable. The spouse who gives up property is not taxed on this, even if the property has appreciated since he or she acquired it. The spouse who receives property is not taxed on receipt. The basis of the property is the same as it was for the spouse who gave it up, so that the spouse who receives the property will recognize gain on any appreciation if and when the property is sold.

As part of a property settlement, one spouse may agree to assume the debts of the other spouse. However, the agreement is between the spouses; it does not affect the rights or actions of other parties. For example, if one spouse agrees in the settlement to pay any outstanding joint tax liability, this does not prevent the IRS (a third party) from pursuing collection from the other spouse.

In one recent case, a wife assumed the debts of the husband as part of their property settlement. When the bank forgave one of the husband's debts, it issued a Form 1099-C, reporting cancellation of debt income to the husband.

He argued that the income belonged to the wife because she had assumed the debts. The Tax Court, however, decided that as to the bank (a third party), the husband continued to owe the debt so he had to report the income from the debt forgiveness.

Legal Fees

Legal fees related to a marital dissolution may or may not be taxable. Whether fees are deductible depends on the origin of the claim: If the fees relate to a personal aspect, such as marital status, they are not deductible. Thus, fees for simply obtaining the divorce are a nondeductible personal expense. And fees for obtaining child support, which is nontaxable to the recipient and nondeductible by the payor, also are not deductible.

If the fees are related to producing income or to business property, they *may* be deductible. For example, legal fees related to obtaining taxable alimony are deductible. In one case, the Tax Court allowed a portion of a husband's legal fees in a divorce action to be deductible because they related to his collection of rents (taxable income).

Income Tax Brackets

The six income tax brackets—10 percent, 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent—have not changed for 2010. However, income for some of the brackets has been increased for inflation. This means you can have more income without being bumped into a higher tax bracket. Most taxpayers may not even realize that the brackets have increased because they take their tax liability from an IRS table for this purpose, as mentioned earlier in this chapter. They look down the column for their filing status until they see the range into which their taxable income falls. However, to give you an idea of the tax rate you're actually paying on your income, it's helpful to view the tax rate schedules. Tables 6.3 through 6.6 show the complete tax brackets for all filers in 2010.

Your Tax Bracket

When someone says, "I'm in the 28 percent tax bracket," what does this mean? Since we have a graduated income tax scheme, when you are in the 28 percent tax bracket, you pay some tax at 10 percent, some at 15 percent, some at

TABLE 6.3 2010 Tax Rate Schedule for Married Filing Jointly and Qualifying Widow(er)

If Taxable Income Is Over	But Not Over	The Tax Is	Of the Amount Over
0	$ 16,750	10%	0
$ 16,750	68,000	$ 1,675 + 15%	$ 16,750
68,000	137,300	9,362.50 + 25%	68,000
137,300	209,650	26,687.50 + 28%	137,300
209,650	373,650	46,833.50 + 33%	209,650
373,650		101,085.50 + 35%	373,650

TABLE 6.4 2010 Tax Rate Schedule for Head of Household

If Taxable Income Is Over	But Not Over	The Tax Is	Of the Amount Over
0	$ 11,950	10%	0
$ 11,950	45,550	$ 1,195 + 15%	$ 11,950
45,550	117,650	6,235 + 25%	45,550
117,650	190,550	24,260 + 28%	117,650
190,550	373,650	44,672 + 33%	190,550
373,650		105,095 + 35%	373,650

TABLE 6.5 2010 Tax Rate Schedule for Single Taxpayer

If Taxable Income Is Over	But Not Over	The Tax Is	Of the Amount Over
0	$ 8,375	10%	0
$ 8,375	34,000	$ 837.50 + 15%	$ 8,375
34,000	82,400	4,681.25 + 25%	34,000
82,400	171,850	16,781.25 + 28%	82,400
171,850	373,650	41,827.25 + 33%	171,850
373,650		108,421 + 35%	373,650

TABLE 6.6 2010 Tax Rate Schedule for Married Filing Separately

If Taxable Income Is Over	But Not Over	The Tax Is	Of the Amount Over
0	$ 8,375	10%	0
$ 8,375	34,000	$ 837.50 + 15%	$ 8,375
34,000	68,650	4,681.25 + 25%	34,000
68,650	104,625	13,343.75 + 28%	68,650
104,625	186,825	23,416.75 + 33%	104,625
186,825		50,542.75 +35%	186,825

25 percent, and some at 28 percent. Reference to your tax bracket means the *highest* rate at which you pay any tax.

It is helpful to understand your tax bracket. You can use it for tax planning purposes to estimate what additional income will cost you and what additional write-offs will save you.

Example

You are in the 28 percent bracket. You could earn an additional $1,000 this year. Doing so will cost you $280 in federal income taxes. In actuality, it could cost you even more if the additional income pushes you over the top of the 28 percent tax bracket and into the 33 percent bracket (and cost you as much as $330 in federal income taxes). Understanding the tax bracket you are in as well as the break points for the tax brackets enables you to plan for your income and deductions to minimize the impact of the tax brackets on what you pay in taxes.

Alternative Minimum Tax

The alternative minimum tax (AMT) is a shadow tax system designed to ensure that all individuals—even those with substantial write-offs—pay at least some federal income tax. The AMT came about in 1969 when Congress learned that 166 wealthy individuals paid no tax. Now, however, the AMT affects millions of middle-income taxpayers who are not trying to avoid regular income taxes. The reason: Unlike the tax brackets for the regular income tax, the two AMT rates of 26 percent and 28 percent are *not* indexed annually for inflation, so as the regular tax declines, more and more people become subject to the AMT.

Here is a brief overview of how the AMT works so you can understand where tax changes fit in and how you can plan to minimize or avoid the AMT. Essentially, after you've figured your regular tax (before taking credits into account), you have to refigure your income for alternative minimum tax purposes. You figure alternative minimum taxable income (AMTI) by adding back deductions that are allowed for the regular tax but not for the AMT, such as state and local income taxes and miscellaneous itemized deductions (called "adjustments"). Some adjustments, such as income from a state tax refund, reduce AMTI. You also increase AMTI by tax preference items listed in the tax law, such as the spread between the exercise and strike price of an incentive stock option. Then you reduce AMTI by the exemption amount allowed for your filing status (exemption amounts are listed below). Next you apply the AMT tax rates of 26 percent and 28 percent. You can reduce the alternative minimum tax by certain credits, explained below.

Exemption Amount

As explained earlier, you reduce alternative minimum taxable income by your AMT exemption, the amount of which depends on your filing status. The AMT exemption amounts for 2010 are scheduled to drop dramatically from the amounts for 2009, as show in Table 6.7 (2009 amounts are included for comparison purposes).

Alert

The AMT exemption amounts for 2010 may be increased above the amounts shown in the table. Congress could even authorize the increases for 2010 after the end of 2010; check the Supplement for details.

TABLE 6.7 AMT Exemption Amounts

Filing Status	AMT Exemption 2009	AMT Exemption Scheduled for 2010
Single and head of household	$46,700	$33,750
Married filing jointly and surviving spouse	70,950	45,000
Married filing separately	35,475	22,500

For a child subject to the kiddie tax on unearned income, there is a special AMT exemption; this exemption amount in 2010 is the same as it was in 2009. The child's AMT exemption amount in 2010 is limited to $6,700, plus earned income. However, the child's AMT exemption amount cannot exceed the exemption amount for a single individual—set to be $33,750 in 2010.

PLANNING

The fate of the AMT in the future is uncertain. The AMT now raises too much revenue to eliminate easily, but this tax could affect many millions more if Congress doesn't do something. For the past several years, Congress has applied a "patch" to the problem by annually raising the exemption amount. Despite promises to revamp the AMT system, Congress has been unable to reach an agreement on how to do this. Expect to see continued increases in the exemption amount (perhaps adjusting the current amount for inflation each year) until a permanent solution can be found.

In any event, you need to control adjustments and preference items to the extent possible. If you have too many adjustments and preferences, you may find yourself subject to the AMT. It's virtually impossible to estimate the point at which adjustments and preferences will trigger the AMT (computer programs are needed for precise estimates). As a rule of thumb, however, if you have over about $20,000 of adjustments and preferences, you could be subject to the AMT. Planning with respect to these adjustments and preferences can reduce or eliminate any AMT liability.

Deduction planning. No deduction is allowed for AMT purposes for state and local income taxes, so the timing of your state and local income and property tax payments is critical. Before you make any year-end payments of these taxes otherwise due in January of next year (a move that could save regular taxes this year but cause you to effectively lose any benefit from them because of the AMT), determine whether you'll owe AMT this year.

No deduction is allowed for AMT purposes for miscellaneous itemized deductions. If, for example, you have substantial legal expenses, unreimbursed employee business expenses, investment expenses, or other miscellaneous expenses, you lose the benefit of their deduction if they trigger or increase AMT. To avoid this result, watch your miscellaneous deductions.

- Check to see that your employer uses an accountable plan to cover employee business expenses. Under an accountable plan, employer advances or reimbursements for travel and entertainment costs are not treated as income to

you (you merely substantiate your business expenses to your employer and return any excess reimbursements). In contrast, with a nonaccountable plan, employer reimbursements for your business expenses are treated as additional income to you. Then you can deduct your business expenses, but only as a miscellaneous itemized deduction. Such expenses become deductible only to the extent that the total exceeds two percent of your adjusted gross income. But this itemized deduction is *not* allowed for AMT purposes.

- If you have a legal action involving a contingency fee, be sure that the arrangement creates an interest for the attorney in the recovery under your state's law so that you'll report only the net recovery (the amount you receive after the attorney receives his/her share). If you do not, or if state law does not create such an interest, then you'll have to report the recovery in full and claim any legal fees as a miscellaneous itemized deduction in excess of two percent of adjusted gross income (but no deduction for AMT purposes).
- Think twice about which individual should benefit under a multiple support arrangement that allows anyone who contributes at least 10 percent of someone else's support to claim the dependency exemption (provided the group contributes more than 50 percent of the person's support). Because personal and dependency exemptions are not deductible for AMT purposes, it usually makes sense to "award" the dependency exemption to a supporter who is not subject to the AMT.
- Watch the timing for exercising incentive stock options (ISOs). When you exercise the options to buy a set number of shares of your employer's stock at a set price within a set time, this does not produce any income for regular tax purposes. However, the spread between the option price and stock price on the date the ISOs are exercised is an adjustment to alternative minimum taxable income. In effect, even though the exercise of ISOs does not produce any regular income tax consequences, such action may trigger the AMT. Generally it is advisable to spread the exercise of ISOs over a number of years rather than exercising them all at once. This will minimize any adverse tax impact. But tax considerations may have to take a back seat to other factors. Consider moves in the stock prices as well as the availability of cash to exercise the options and watch out for expiration dates on the options.

Private Activity Bond Interest

Private activity bonds are a municipal security issued to finance a private activity such as a sports stadium. The interest on private activity bonds is not taxed for regular tax purposes (although it is taken into account for purposes of determining taxation on Social Security benefits). Usually interest on most private activity bonds issued after August 7, 1986, is treated as a tax preference for AMT purposes. However, for 2009 and 2010, there is an exception from the AMT preference rule for interest on private activity bonds. This exception also applies to bonds issued to refund bonds issued after December 31, 2003, and before January 1, 2009.

The exception also applies to distributions from private activity bond funds to the extent of interest on bonds issued in 2009 and 2010.

PLANNING

The new exception is in addition to exceptions for interest on the following types of bonds:

- Qualified 501(c)(3) bonds
- New York Liberty bonds
- Qualified Gulf Opportunity bonds
- Qualified mortgage bonds
- Veteran's mortgage bonds
- Qualified student loan bonds
- Exempt-facility bonds issued after July 30, 2008

Small Business Stock

Gain on the sale of stock in a privately-held C corporation that has been held for at least five years may be partially or fully tax free, depending on when it was issued:

- Before February 18, 2009, and after December 31, 2010: 50 percent (60 percent for stock of corporations within empowerment zones issued before January 1, 2010)
- After February 17, 2009, and before September 28, 2010: 75 percent
- After September 27, 2010, and before January 1, 2011: 100 percent

A portion of the gain for stock issued February 17, 2009, and before September 28, 2010, is includible in alternative minimum taxable income. The inclusion amount for AMT is 46 percent, which produces an effective maximum AMT rate of 12.88 percent (46 percent inclusion multiplied by the 28 percent maximum AMT rate). For gain on stock issued after September 27, 2010, and before January 1, 2011, there is *no* inclusion rate, so no part of the gain is subject to AMT.

A portion of the gain from the sale of this small business stock that is excludable from income for regular tax purposes is includible in alternative minimum taxable income. The inclusion amount for AMT is 46 percent. This produces an effective maximum AMT tax rate of 12.88 percent (46 percent inclusion multiplied by the 28 percent maximum AMT rate).

Tax Credits

Just because you have a tentative AMT liability doesn't mean you'll have to pay any AMT. It can be offset by a variety of tax credits, including the retirement savers credit and the child tax credit. It can be offset by the alternative motor vehicle credit for buying a hybrid vehicle or a plug-in electric vehicle to the extent used for personal purposes. Also, eligible small business credits in the general business credit can be used to offset AMT in 2010; this could not be done in 2009.

For 2010, AMT liability *cannot* be offset by other nonrefundable personal credits such as the education credit and the dependent care credit. The offset by nonrefundable credits expired at the end of 2009.

Alert

There may be an extension of the offset to AMT by nonrefundable credits in 2010; check the Supplement for details.

Income and Deduction Planning Strategies

The tax brackets will likely be changed again in 2011—through allowing current law to expire or by revising current law. Recognizing this allows you to do tax planning that can reduce your taxes in both 2010 and 2011. Whether you use

these planning strategies depends, of course, on your personal tax picture and on financial considerations.

Income Deferral

Shifting income from the current year into a future year (effectively postponing the receipt of income that you would have received this year into next year) saves you money because it postpones the time when you pay the tax on the income. For example, if you receive income in December 2010, you owe the tax on that income by April 15, 2011. But if you can defer that income to January 2011, you don't owe the tax until April 15, 2012.

Postponing taxes isn't the only reason for deferring income. When the tax brackets for the following year are adjusted for inflation, income shifted from this year into next may be taxed at a *lower* rate. Inflation, in effect, increases the top end of the tax bracket so you can earn more income without being pushed into a higher tax bracket. Of course, it is unknown at this time whether any inflation adjustment will be applied to 2010 brackets in view of the expiration of the 2001 Tax Act, discussed in the Introduction to this book. If current tax brackets are retained, then inflation adjustments could apply.

Whether income deferral results in any tax savings depends on whether you'll be in a lower tax bracket. This depends on your personal situation (e.g., retirement with lower income, going from two-income to one-income family, etc.).

Example

You have $1,000 income that you can shift to 2011 instead of realizing it in 2010. (For instance, you're a self-employed person and wait until the end of December to bill $1,000 for services performed so that payment will be received in January 2011.) Assume that if you had received the payment in 2010, it would have exceeded the limit for the 15 percent tax bracket and so would have fallen into the 25 percent bracket. But because you receive the income in 2011, it is still in the 15 percent bracket because of adjustments made to the bracket that allow more income to be received at that rate. So instead of paying $250 tax on the $1,000 income ($1,000 × 25 percent), you pay only $150 tax on that same income ($1,000 × 15 percent), a $100 tax savings.

How do you defer income into a later year? There are several proven strategies you can use to shift income from one year to the next.

- Make investments that pay income after December 31 of the current year. Use certificates of deposit (CDs) and Treasury bills purchased that come due after the end of the year. To be tax deferred, the term of the CD or Treasury bill must be under one year and interest cannot be payable prior to maturity. Otherwise, the interest is reported throughout the term of the instrument rather than upon maturity.
- If you are self-employed with a full-time or part-time business and you use the cash method of reporting for your income and expenses, you might want to delay year-end billing so that accounts receivable for work performed this year or goods sold this year will be paid next year. Of course, this deferral strategy is *not* a good idea if your customers are financially shaky and you're concerned about collecting payment; instead bill (and collect) as soon as possible. It's also not advisable if you expect business next year to be worse than this year, resulting in lower income next year.

On the other hand, if you anticipate being in a higher tax bracket in 2011 than you are in 2010, deferral may not be the best strategy for you. It is true that deferral postpones the time at which taxes must be paid. Ultimately, however, you'll pay more in taxes because of the higher tax bracket in 2011.

What about longer deferral? If, for example, you have the option of deferring a bonus until retirement, should you do this? Usually, long-term deferral has proven to be an effective tax-saving strategy because of the annual adjustment to the tax brackets for cost-of-living changes. However, this strategy may not work for long. As mentioned earlier, the current low rates are *not* permanent and are scheduled to sunset at the end of 2010, so that starting in 2011, the 10 percent bracket is set to disappear and the rates above the 15 percent rate rise to 28 percent, 31 percent, 36 percent, and 39.6 percent (the rates that were in effect prior to the 2001 Tax Act) or even higher if Congress so decides.

Because it is impossible to predict what tax rates may be in 10 years, 20 years, or longer, long-term deferral probably doesn't make sense for everyone. However, even if the taxes may be higher on the deferred income, deferral may be appealing as a way to create a fixed amount of retirement income, a welcome certainty in this current uncertain investment climate.

For younger workers, with a very long time before retirement, several reliable strategies can be used to defer certain income well into the future; the long deferral period in which no taxes are paid may very well offset any tax hike that could apply when taxes eventually are paid on the deferred income years from now.

- Make contributions to tax-deferred accounts, such as 401(k) plans, 403(b) annuities, 457 plans, deductible IRAs, and commercial annuities. If you wait to take distributions until you retire and your income is lower at that time, you may find yourself in a lower tax bracket then than you are now (even if tax rates increase).
- Arrange for deferred compensation if you have a long time horizon and you are confident of the stability of your employer. You must agree to deferral before you earn the compensation or bonus. Again, having lower income following retirement, when deferred compensation is received, could mean that the deferred compensation would still be taxed at a lower rate than it would be if received currently, even with higher tax rates in the future.

Once you decide you want to defer income, you have to do it correctly to gain the tax results you want. You can't shift income merely by refusing to accept it this year. Under a tax rule called "constructive receipt," if you have the right to the income now, it's taxable to you even if you don't accept it. For example, if you receive your paycheck at the end of December, it's taxable to you even though you don't cash or deposit it until January.

Deduction Acceleration

The higher your tax bracket, the more valuable a deduction is to you. So you might want to accelerate deductions that you otherwise would have taken next year into this year if you expect to be in a lower tax bracket next year.

Accelerate or not? It depends on your tax bracket this year and what you expect it to be next year. In 2010, there is no phaseout of itemized deductions (including charitable contributions) on high-income taxpayers; this rule is set to expire at the end of 2010, with a phaseout returning in 2011. Thus, while tax

Example

You itemize deductions and are planning to make a $1,000 charitable contribution next year. Assume that you're in the 25 percent tax bracket but expect to be in the 15 percent tax bracket next year because you won't have the same profitable investment sales next year. If you accelerate your $1,000 contribution deduction to this year, you'll save $250 in taxes; if you wait until next year, the contribution deduction will save you only $150. Acceleration creates an added $100 tax benefit.

brackets may be higher in 2011 (which makes deductions more valuable), the phaseout of itemized deductions could limit allowable write-offs.

Many deductions are dependent on timing that you can't change; you really can't change the mortgage payments and the interest deduction they generate (even if you pay additional principal, it won't alter the interest payments for the year). But here are some strategies you can use to accelerate deductions into the current year:

- Make discretionary expenditures—elective medical procedures that are not reimbursed by insurance or covered by flexible spending arrangements or health savings accounts but that are deductible (e.g., additional prescription sunglasses) and charitable contributions. Medical or charitable expenses that are charged by a major credit card no later than the end of the year are deductible in 2010 even though the credit card bill isn't paid until 2011.
- Prepay state and local income and real estate taxes, as long as you aren't subject to the alternative minimum tax, because these taxes are not deductible for AMT purposes (as explained earlier in this chapter).
- If you are self-employed with a full-time or sideline business on the cash method of accounting, prepay certain expenses that can be deducted this year. *Examples:* Buy supplies needed for the coming year, pay off outstanding bills, and pay membership dues for the year. But don't prepay multiyear items (e.g., three-year subscriptions or multiyear insurance premiums), since they are deductible only over the period to which they relate. Payments charged to a major credit card by the end of 2010 are deductible this year even though the credit card bill isn't paid until 2011.

Other Strategies

As the standard deduction amount rises each year, fewer taxpayers have enough personal deductions to itemize. As you approach the standard deduction amount limits, consider bunching itemized deductions. This means pushing deductions to or from the current year so that you itemize one year and claim the standard deduction the next year.

Example

You are single and in 2010 your itemized deductions total $5,600. Next year you expect your itemized deductions to be about the same. You're planning on making a $100 charitable contribution in 2010 and a $100 charitable contribution next year. If you make the full $200 contribution in 2010, it will be worthwhile for you to itemize (your deductions of $5,800 are more than the standard deduction amount of $5,700). If you follow the original plan to spread the contribution over two years, your deductions will not exceed the standard deduction in either year and you'll receive no tax benefit for the charitable contribution.

Income Shifting

Income shifting is yet another great strategy for saving taxes for a family. For example, if you are supporting a parent who has little or no taxable income, consider giving income-producing property to your parent. Your parent can use the income toward his or her own support and will pay little or no tax on the income. You also might want to give appreciated property and let the parent sell the property. The resulting capital gain likely will be taxed to the parent at a lower rate than it would be taxable to you (depending, of course, on capital gain rates in 2011).

If you are in a high tax bracket, also consider giving some income-producing property to your child. Even if the child is subject to the kiddie tax (see Chapter 1), he or she can receive unearned income up to $1,900 in 2010 and still pay tax at a low tax bracket (the first $950 of such income is tax free; the second $950 is taxed at only 10 percent, for a total tax on the $1,900 of $95). It would take $38,000 of investment dollars earning 5 percent (or $47,500 earning 4 percent) to generate $1,900 of investment income for your child.

CHAPTER 7

Tax-Saving Changes for the Self-Employed

If you are self-employed with a full-time or part-time business, you may be eligible for a number of business-related tax breaks. Most of the business deductions are a direct offset to your business income, reducing the profits that are subject to tax. Some of the business deductions, however, are claimed as personal deductions; they are reported as an adjustment to gross income. While they have the same impact for income tax purposes, effectively reducing the amount of business income you'll pay tax on, they are not a reduction for self-employment tax purposes. There are also special business-related tax credits you may be eligible for.

If you are an employee and you are not reimbursed for your business expenses, some of the breaks in this chapter may apply to you. For example, if you drive your personal car for business, you too can deduct the cost of business driving. If you use a home office for the convenience of your employer, you can claim a home office deduction.

This chapter explains the changes in business deductions and credits you may be eligible for in 2010 and what lies ahead. Use this information to help yourself plan for tax savings on your return for 2010 as well as for 2011 and later years. Many tax rules have not changed for 2010; these basic rules (along with tax changes) can be found in *J.K. Lasser's Small Business Taxes 2011.*

First-Year Expensing

A small business can elect to expense the cost of buying equipment—computers, office furniture, machinery, and the like—instead of depreciating the cost over a period fixed by law, typically five to seven years. This sometimes is referred to as the Section 179 deduction because this is the section in the Internal Revenue Code governing the rule.

There is a set dollar limit on the amount that can be expensed annually. For 2010, that limit generally is $500,000, up from the $250,000 limit that was permitted for 2009.

Alert

An additional $35,000 could have been expensed if the property was placed in service in an empowerment zone or on an Indian reservation, but this could be extended for 2010; check the Supplement for details.

The $500,000 limit phases out once a business's annual equipment purchases exceed the basic $2 million. For every dollar over $2 million, the expense limit is reduced by $1 so that once equipment purchases exceed $2,500,000 in 2010, no expensing is permitted.

For 2010 and 2011, there is a special rule for qualified leasehold, restaurant, and retail improvements. Ordinarily these are real property costs that have to be depreciated over 39 years (although there had been a 15-year amortization rule in 2009). Now these costs can be expensed up to $250,000.

PLANNING

First-year expensing applies whether you pay cash or finance your equipment purchase over time. It applies to property that is new as well as pre-owned. It does not apply to property you lease. However, in some cases it may make more tax sense to lease rather than buy, even with the $500,000 write-off opportunity. You can deduct lease payments even if you're not profitable; they effectively add to your net operating loss, which can be carried back to generate a tax refund.

If you want to use expensing and make the most of it when purchasing more than $500,000 worth of equipment, it is advisable to elect expensing for the property with the longest depreciation recovery period.

First-year expensing must be elected; it is not automatic. Whether it makes sense to make the election depends on your tax picture this year and looking ahead. To benefit from first-year expensing, you must have taxable income at least equal to the amount you want to expense. You cannot use first-year expensing to create or increase a net operating loss. If 2010 is not a profitable year, then you won't benefit from an expensing election. In this case it makes more sense *not* to make the election and instead claim depreciation in future years when you can benefit from the write-offs. If you own a pass-through entity (e.g., an S corporation or a partnership), both the dollar limit and the taxable income test apply at *both* the entity level and the owner level; the expensing election is made only at the entity level alone.

You make the first-year expensing election in Part I of Form 4562, *Depreciation and Amortization* (see Appendix C).

Looking ahead, the $500,000 limit also applies for 2011 but is scheduled to revert in 2012 to the former limit of $25,000, with no annual adjustment for inflation. It is likely, however, that a higher limit will be enacted.

Bonus Depreciation

Bonus depreciation, a rule first introduced in 2002 for property purchased after September 10, 2001, affects the timing of depreciation allowances; it does not increase the total amount that can be written off for depreciable property. The provision had expired but was reinstated for 2008 and continued for 2009 and again in 2010. The bonus depreciation rate for 2010 was 50 percent, which means you could write off half the cost of eligible property purchased in this year.

Example

In 2010 your business places in service new equipment costing $300,000 (assume the property has a five-year recovery period, which results in a 20 percent depreciation allowance for the first year). You elect first-year expensing up to $250,000 and apply bonus depreciation. Your total write-off for the year is $280,000, or about 93 percent of the cost ($250,000 first-year expensing, $25,000 bonus depreciation [50 percent of $50,000], and $5,000 regular depreciation [20 percent of $25,000]).

Bonus depreciation can be claimed in addition to any first-year expensing that may be claimed. A regular depreciation allowance also can be claimed. Bonus depreciation is applied to the adjusted basis of the property. Generally this is the cost of the property minus any first-year expensing.

As mentioned earlier, bonus depreciation is designed merely to accelerate the write-off for equipment. It does not increase the total write-offs that may be claimed—this continues to be limited to the property's basis (generally cost).

Qualifying Property

Most types of depreciable property qualify for bonus depreciation. For example, it may be claimed for software that has a three-year recovery period. Bonus depreciation also applies to qualified leasehold improvement property (improvements to the interior of nonresidential property made under a lease by the lessee, sublessee, or lessor), qualified restaurant improvements, and qualified retail improvements. Further, it applies to property elected to be depreciated under the alternative depreciation system (ADS).

Nonqualifying property includes the following items:

- Intangibles (e.g., trademarks and goodwill) that you acquire, which are required to be amortized over 15 years.
- Property that *must* be depreciated under the ADS, such as cell phones and other listed property not used more than 50 percent for business, and any property used predominantly outside the United States.

Bonus depreciation applies only to new property and not to used property. But financing the purchase in whole or in part does not impede the write-off.

Other Rules

In the tax law there is a special depreciation rule called the mid-quarter convention. This rule says that if the total cost basis of business equipment placed in service during the last three months of the year exceeds 40 percent of the total basis of all property placed in service during the year, then all equipment is treated as having been placed in service in the middle of the

quarter. However, bonus depreciation, if extended, is not taken into account in determining the basis of property for purposes of the mid-quarter convention. Thus, the basis of property placed in service in the last quarter of the year is determined without regard to bonus depreciation.

Example

In June, your business places in service equipment costing $30,000. In December of the same year, you also place in service more equipment costing $125,000. The determination of whether the mid-quarter convention applies to these items is based on the cost of the items without regard to any bonus depreciation.

Electing Out of Bonus Depreciation

Assuming bonus depreciation applies, you are not *required* to use bonus depreciation even though you are qualified to use it. Bonus depreciation applies automatically unless you elect out of it. It may make sense to elect out of bonus depreciation if your current income is not enough to benefit from the added write-off but you expect income to improve in coming years. However, unlike first-year expensing, bonus depreciation can be used to create or increase a net operating loss, so think twice before letting it go.

If you do decide to opt out of bonus depreciation, note that the election out applies to all property within the same recovery class. Thus, for example, if you want bonus depreciation to apply to some five-year property, it must apply to all five-year property. By the same token, if you want to elect out of bonus depreciation for some seven-year property, the election out prohibits bonus depreciation for any other seven-year property.

The election out of bonus depreciation is made on in Part II of Form 4562, *Depreciation and Amortization* (see Appendix C). It must be made no later than the due date of the return (including extension) for the year the property is placed in service (for example, by April 15, 2011, plus any filing extensions, for 2010 property).

Caution: If you want to make the election out but fail to do so properly, you must reduce the property's basis by the amount that you could have claimed as bonus depreciation, even if you didn't take the deduction. This will affect

the amount of your gain (or loss), including depreciation recapture, when you dispose of the property.

PLANNING

Determine whether it's advisable to elect not to claim bonus depreciation, as explained earlier.

CELLULAR PHONES

Until now, cell phones have been treated as "listed property," which means that their cost can be expensed or depreciated more rapidly only if more than 50 percent of the use is for business and not for personal purposes. Records had been required to prove business use. Under a law change, cell phones have been "delisted;" they are now treated like most other types of equipment. When buying a cell phone, the business portion can be expensed or depreciated rapidly, but de minimis personal use won't prevent this favorable tax treatment.

Dollar Limits on Car Deductions

If you buy a car, light truck, or van used in a business, you can deduct your actual costs, including an allowance for depreciation or first-year expensing. However, there is a dollar limit on depreciation write-offs for cars weighing no more than 6,000 pounds gross vehicle weight as rated by the manufacturer that are considered luxury cars (cars costing over a set amount). Heavier vehicles, such as certain SUVs, are exempt from the dollar limits but can be expensed only up to $25,000.

Table 7.1 shows the dollar limit on depreciation (and first-year expensing) for passenger cars placed in service in 2010.

TABLE 7.1 Deduction Limit on Passenger Cars Placed in Service in 2010

Year	Dollar Limit
2010	$3,060*
2011	4,900
2012	2,950
2013 and later years	1,775

*$11,060 if the car qualifies for bonus depreciation (i.e., a new car).

The full dollar limit applies only to cars used 100 percent for business. If you use your car 80 percent for business and 20 percent for personal purposes, you must allocate the dollar limit.

Example

You buy a pre-owned car for $25,000 in March 2010. (Assume the car weighs less than 6,000 pounds.) You use it 80 percent for business and 20 percent for personal reasons. The most you can deduct in the first year of car ownership is $2,448 ($3,060 × 80 percent).

Dollar Limits on Trucks and Vans

Light trucks and vans weighing no more than 6,000 pounds are subject to the special dollar limits. Table 7.2 shows the dollar limit on depreciation (and first-year expensing) for light trucks and vans placed in service in 2010.

There is no dollar limit on the purchase of non-personal-use vehicles. These include vehicles not likely to be purchased for other than business (e.g., a van equipped with special shelving for the business).

Standard Mileage Rate

Instead of deducting your actual expenses for the business use of your car, you can opt to claim an IRS standard mileage allowance. This standard mileage rate applies to both owned and leased cars used for business. The standard mileage rate takes the place of deducting gas and oil, insurance, depreciation on purchased cars (or lease payments on leased cars), and repairs and maintenance.

TABLE 7.2 Deduction Limit on Light Trucks and Vans Placed in Service in 2010

Year	Dollar Limit
2010	$3,160*
2011	5,100
2012	3,050
2013 and later years	1,875

*$11,060 if the truck or van qualifies for bonus depreciation (i.e., a new vehicle).

For 2010, the standard mileage rate is 50 cents per mile; in 2009 it was 55 cents per mile.

As mentioned earlier, the IRS's standard mileage rate may be claimed whether you own or lease the car. However, it may not be claimed if you deducted actual expenses for the car in a prior year.

Deemed Depreciation

If you deduct your actual costs for a vehicle you own, you reduce the basis of the vehicle by the applicable depreciation allowance. If you claim the standard mileage rate, you must reduce the basis of your car by a "deemed depreciation amount" fixed by the IRS. The reduction in basis is necessary for determining how long the standard mileage rate can be claimed (it cannot be claimed after the car has been fully depreciated according to deemed depreciation). The basis reduction is also necessary for determining gain or loss on the sale of the car. For 2010, the deemed depreciation rate is 23 cents per mile (in 2009, the deemed depreciation rate was 21 cents per mile).

Example

You buy a $25,000 car in 2010. You drive it 30,000 miles on business. You must reduce the basis of the car by $6,900 (30,000 × $0.23). Assuming the deemed depreciation rate remains unchanged in the coming years and you continue to drive 30,000 miles a year, your car will be fully depreciated within four years—and no additional standard mileage rate may be claimed after that.

PLANNING

If you buy or lease a car for business in 2010, decide whether it's better to use the actual expense method or the IRS standard mileage rate to deduct the car's operating costs. Remember that the standard mileage rate replaces write-offs for depreciation (or lease costs on leased cars), gas, oil, repairs, licenses, and insurance. If you use the standard mileage rate in the first year, you can switch to the actual expense method in a subsequent year—but you are limited to claiming straight-line depreciation if you own the car (no accelerated depreciation is permitted). Again, if you use the actual expense method in the first year, you cannot later switch to the standard mileage rate.

The choice of which method to select depends on a couple of factors:

- *Records for actual costs*. Using the standard mileage rate eliminates the need to keep receipts for gas, oil, and so on. It does *not* eliminate the requirement to substantiate business use of the car (keeping a written or electronic record of the business use).
- *Amount of miles*. The more you drive, the greater the standard mileage rate proves to be, especially for modestly priced cars since the same rate applies regardless of the car's sticker price. For example, if a car is driven 40,000 miles for business in 2010, the deduction under the standard mileage rate is $22,000. This same deduction applies whether the car is a low-priced Toyota Yaris or an expensive Mercedes.

Cents-per-Mile Valuation Rule

If you have an employee who works for your business and the business provides him or her with a passenger car for personal and/or business use, the value of such personal use is a taxable fringe benefit. For 2010, you can opt to value personal use using the vehicle cents-per-mile value rule if the car's fair market value on the date it is first made available to the employee does not exceed $15,300 ($16,000 for a light truck or van).

PLANNING

The fair market value limit for the cents-per-mile rule can be adjusted annually. Before arranging for reimbursements for employees in 2011, check the limit applicable for 2011.

Leased Cars

In order to roughly equate the write-offs allowed for leased cars with those for cars that are owned and depreciated, a special amount must be added back to income for leased cars. This is called an inclusion amount. For 2010, it applies when the original cost of the car exceeds $16,700. Table 7.3 shows some of the inclusion amounts for passenger cars first leased in 2010 (a complete list can be found in Rev. Proc. 2010-18).

TABLE 7.3 Sample Inclusion Amounts for Passenger Cars First Leased in 2010

Fair Market Value		Tax Year during Lease				
Over	**But Not Over**	**1st**	**2nd**	**3rd**	**4th**	**Later**
$16,700	$17,000	$ 3	$ 7	$ 10	$ 11	$ 14
18,000	18,500	6	13	18	23	26
20,000	20,500	11	23	35	42	48
22,000	23,000	14	31	46	56	63
25,000	26,000	20	44	66	78	90
30,000	31,000	32	70	104	125	144
35,000	36,000	40	87	130	156	179
40,000	41,000	50	109	162	194	224
45,000	46,000	60	131	194	232	269
50,000	51,000	69	153	226	271	313

Example

You lease a car in January 2010 that costs $50,000. For 2010, the first year of the lease, you must add to income $69. In 2011, the inclusion amount is $153.

For cars first leased for business *before* 2010, inclusion amounts to be reported in 2010 and later years can be found in IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*, at www.irs.gov.

Plug-in Electric Vehicles

If, in 2010, you purchase a plug-in electric vehicle used for business, you can claim a tax credit. The credit amount is explained in Chapter 5 and can be claimed for an eligible vehicle whether it is used for personal driving or for business.

However, the extent to which the credit is claimed for business becomes part of the general business credit. The general business credit is not a separate credit. Rather, it is an overall limitation on the amount of credits a business can claim in any one year. The general business credit limit is your net income tax (regular tax liability plus alternative minimum tax), minus the greater of (1)

your tentative minimum tax or (2) 25 percent of your net regular tax liability that is more than $25,000 ($12,500 for married persons filing separately).

High-Low Substantiation Rates

If you have employees who travel on business, instead of deducting the actual cost of their lodging, meals, and incidental travel expenses, employees can substantiate business travel using a special high-low substantiation method. This method provides standard rates for travel to specific locations—the locations are either high-cost areas or not. The rates apply only to travel within the continental United States. High-cost areas include Chicago, New York City, San Francisco, and Washington, DC. Certain locations may be high-cost areas for only certain times of the year, such as Aspen, Miami, and Nantucket, so check carefully.

On October 1, 2009, rates took effect for the fiscal year ending September 30, 2010 (the federal government uses this fiscal year even though you probably report on a calendar-year basis). The rate for travel to any high-cost locality is $258 a day, which takes into account $65 a day for meals. The rate for travel to any other locality within the continental United States is $163, which takes into account $52 a day for meals.

However, new rates apply starting October 1, 2010, through September 30, 2011: $233 to high-cost areas and $160 to other localities within the continental United States (the meal rates are unchanged).

PLANNING

You may elect to use the high-low rates that became effective on October 1, 2009, for the final quarter of 2010. Alternatively, you may use the old rates through September 30, 2010, and the new rates for the final quarter of 2010.

Instead of using the high-low rates set by the IRS, you can use the federal per diem rates fixed by the General Services Administration. Again, the rates vary with location. You can find these rates at www.gsa.gov (click on "per diem rates").

Even though employees are on the road, their meals are still subject to the 50 percent limitation. Thus, of the $52 per day for meals for travel to low-cost areas, only $26 is deductible.

Self-Employed Retirement Plans

Self-employed individuals can shelter some of their profits and save for their retirement on a tax-advantaged basis by using a qualified retirement plan, such as a profit-sharing plan or a 401(k) plan. Other retirement plan options for self-employed individuals include simplified employed pensions (SEPs) and savings incentive match plans for employees (SIMPLEs). Contributions you make on your own behalf are deductible as an adjustment to gross income; contributions you make for employees are deductible as a business expense that reduces your net earnings from self-employment.

For 2010, you can contribute to a profit-sharing plan (for self-employed individuals this also is referred to as a Keogh plan) or SEP up to a maximum of $49,000; this is the same limit that applied in 2009. The effective contribution rate for these plans cannot exceed 20 percent of your net earnings from self-employment; only net earnings from self-employment up to $245,000 can be taken into account in figuring your contribution.

Example

You are a consultant working alone and file a Schedule C to report your net earnings from self-employment. In 2010, you net $200,000 and set up an SEP to contribute the maximum. Your deductible contribution for 2010 is $40,000 (20 percent of $200,000). If you had earned $245,000 or more, you could have contributed $49,000, the maximum amount allowed for 2010.

If you use a 401(k) or SIMPLE plan, you can make *both* elective deferrals and employer contributions on your own behalf even though you are not an employee or your employer. Elective deferral limits for 401(k) plans and SIMPLE plans are explained in Chapter 3.

If you have employees, you may have to make contributions on their behalf (depending on their eligibility to participate); these contributions are deductible as a business expense. For 2010, if you have a SEP, you'll need to include employees who meet certain service and age requirements and earn at least $550 for the year (the same as in 2009).

PLANNING

Contributions for yourself (not your employees) are entered as an adjustment to gross income. They do not reduce your net earnings subject to self-employment tax. However, small business advocates have been pushing for a change that would allow the deduction directly from net earnings (the change could mean a tax savings of 15.3 percent of your contribution, the amount of self-employment tax that otherwise would be due).

You can make your retirement plan contributions up to the extended due date of the return for the year to which they relate (e.g., October 15, 2011, for a 2010 contribution if you've obtained a filing extension). However, to use this rule for a profit-sharing or other qualified retirement plan, the plan must have been opened (i.e., you signed the necessary paperwork) by the end of the year for which you are making contributions. With a SEP, you can both set up and fund the plan as late as the extended due date of the return.

Home Office Deduction

If your home is your principal place of business or a place to regularly meet and deal with customers, clients, or patients in the normal course of your business, you may qualify for a home office deduction. As long as you use the space regularly and exclusively for business, expenses for the allocable portion of the space are added together to make a home office deduction.

There have been proposals to create a standard home office deduction instead of figuring the actual costs allocable to home office space.

Alert

One proposal pending in Congress when this book went to press was a standard home office deduction of $1,500 annually; check the Supplement for details.

Incentives for Hiring New Employees

If you own a business and have people working for you, the tax law encourages the hiring of certain workers by allowing you to take a tax credit for a portion of

their wages. The type of credit depends on whom you hire and, in some cases, where your business is located.

Payroll Tax Holiday

As an inducement for businesses to hire new workers and alleviate the high unemployment rate, Congress granted a special tax break that runs only for a limited time. The break is a waiver of the employer share of the Social Security tax portion of FICA. Effectively, this could be up to $6,622 per eligible worker ($106,800 × 6.2%).

The break applies to wages paid after March 18, 2010, and before January 1, 2011. The worker must have started on your payroll after February 3, 2010, and before January 1, 2011. It covers both full-time and part-time employees. To be eligible for this break, you must hire someone who has not worked more than 40 hours during the 60-day period preceding the date the individual starts work with you. You don't have to be a detective to verify that your new worker was previously unemployed; instead, you must have the worker sign an affidavit to this effect using Form W-11.

PLANNING

This credit does not apply to employees who are related to you, so you can't get the break if you put your teenager to work for you in the summer.

The credit applies for hiring someone who formerly has been self-employed. As long as the person was not "employed" for the requisite period, you can apply the payroll tax holiday to his or her wages, even though the person may have been earning self-employment income during that 60-day period.

You cannot displace an existing worker if you want to claim this tax break. The holiday applies, however, for someone who previously worked for you. For example, if you laid someone off because of the recession and now hire that person back, you can claim the payroll tax holiday.

Retained Worker Business Credit

If you've hired someone who entitles you to a payroll tax holiday and you retain the worker on your payroll for 52 consecutive weeks, you can claim a tax credit

of $1,000. The employee's pay in the second 26-week period must be at least 80 percent of the pay in the first 26-week period to qualify the employer for the credit.

The credit is part of the general business credit. However, no part of the credit can be carried back to a tax year beginning before March 18, 2010.

PLANNING

This credit applies per eligible employee, so if you've put three new people to work for you, the credit can be $3,000. Because of the 52-week employment requirement, you won't get to claim this credit until you file your 2011 return in 2012.

Work Opportunity Credit

The work opportunity credit is designed to encourage the employment of workers from certain targeted groups, such as former felons and those who are economically disadvantaged. The credit is generally up to 40 percent of a targeted employee's first-year wages up to $6,000 for those who work at least 400 hours.

For 2009 and 2010, there are two new targeted groups:

- Unemployed veterans discharged from active duty within five years of being hired by you and who received unemployment compensation for not less than four weeks during the one-year period prior to the hiring date.
- Disconnected youths at least age 16 but under age 25 who lack education (have not attended any high school, technical school, or postsecondary school during the six-month period ending on the hiring date) and basic skills. An eligible youth has not been regularly employed during the six-month period prior to the hiring date.

PLANNING

If you want to claim the work opportunity credit, you cannot use the payroll tax holiday described earlier in this chapter. You must choose which tax break to use for new employees hired after February 3, 2010, and before January 1, 2011.

Usually, the work opportunity credit will provide a greater tax savings, but you'll have to run the numbers to be sure.

Empowerment Zone and Renewal Community Employment Credit

This credit helps employers who hire workers for a business located within an empowerment zone or a renewal community as long as the workers also live in the zone. These areas are economically challenged and have received special designation from the federal government. The credit is 20 percent of empowerment zone wages up to $15,000 or 15 percent of renewal community wages up to $10,000. Empowerment zones and renewal communities are listed in the instructions to Form 8844, *Empowerment Zone and Renewal Community Employment Credit*, or at www.hud.gov/crlocator.

Alert

The empowerment zone and renewal community employment credit expired at the end of 2009 but could be extended for 2010. Check the Supplement for details.

D.C. Enterprise Zone

The credit is the same as the empowerment zone employment credit except that workers can live anywhere in the District of Columbia.

Alert

The D.C. enterprise credit expired at the end of 2009 but could be extended for 2010. Check the Supplement for details.

Indian Employment Credit

This credit is for hiring a worker who lives on or near a reservation. The credit is 20 percent of the excess of the current qualified wages and qualified employee health insurance costs (not to exceed $20,000) over the sum of the

corresponding amounts that were paid or incurred during the calendar year 1993 (yes, this isn't a typo).

Alert

The Indian employment credit expired at the end of 2009 but could be extended for 2010. Check the Supplement for details.

Wage Differential Payments Credit

While not a credit to induce hiring, this is a reward for small employers who continue to pay some or all of a worker's wages when he or she is called to active duty for a period of more than 30 days. The credit is new for 2009 and applies only for wage differential payments made after 2008 and before 2010 (i.e., only in 2009). It applies only to businesses that regularly employ fewer than 50 employees. The business must adopt a written plan for making wage differential payments.

The credit is 20 percent of the first $20,000 of qualified differential wage payments made to each qualified employee.

Alert

The wage differential payments credit expired at the end of 2009 but could be extended for 2010. Check the Supplement for details.

Research Credit

If you engage in scientific or certain other types of research, you may qualify for a tax credit for increasing your expenditures. The credit, generally 20 percent of increased expenditures, expired at the end of 2009.

Alert

The research credit expired at the end of 2009 but could be extended for 2010 or even made permanent. Check the Supplement for details.

Health Insurance for the Self-Employed

If you pay for coverage for yourself (or for yourself, spouse, and a dependent), normally the deduction is treated as a personal one. Under a special rule, self-employed individuals deduct 100 percent of their premiums as an adjustment to gross income (they do not have to itemize personal deductions to claim this write-off).

Alert

Congress was considering a law change that would allow self-employed individuals to deduct their premiums as a business expense. Check the Supplement for details.

Small Employer Health Credit

To encourage small businesses to pay for some or all of their employees' health care costs, a new law allows qualified businesses to claim a tax credit for a portion of the premiums they pay. Potentially, the credit can be as much as 35 percent of the premiums paid, but the credit is very complex and subject to various limitations.

Small Employer

The credit can be claimed only by a small employer. This is defined as an employer with no more than 25 full-time employees who earn an average compensation of no more than $50,000. "Wages" for purposes of this credit have the same meaning as they do for FICA taxes.

Full-time employees aren't based on a head count, but rather on the hours worked. Thus, a full-time employee is the total number of hours for which employees are paid divided by 2,080. If the result is not a whole number, then round down. When you make this computation, take into account only the first 2,080 hours worked by an employee.

Example

You have four employees. One is a full-time worker who puts in at least 40 hours a week, so this worker equals one full-time worker. You also have three part-timers who work 20 hours each week, or 1,040 per year (based on a 52-week year). Adding up your workers' hours, produces 5,200 hours, which, after rounding down is the equivalent of two full-time workers (5,200 hours ÷ 2,080 = 2.5).

Credit Amount

The credit is up to 35 percent of premiums paid and applies in 2010 through 2013. The credit is based on the lesser of the employer's premium payments or the average health plan rate for small employers in your state. The average rate is set by the Department of Health and Human Services. The IRS has announced the rates for 2010 and cover amounts by state for employee-only coverage and family coverage.

The credit is reduced by 6.667 percent for each full-time employee in excess of 10. Thus a partial credit applies for a small employer with 11 to 25 full-time employees.

The credit also is reduced for wages above $25,000. The reduction amounts to 4 percent for each $1,000 of wages above $25,000 (e.g., average annual compensation of $30,000 results in a 20 percent credit amount reduction).

The credit is figured on Form 8941, *Credit for Small Employer Health Insurance Premium.*

PLANNING

The credit can be claimed for up to four years, as long as you continue to be a "small employer." The credit applies for both regular tax and alternative minimum tax purposes.

The credit cannot be claimed for certain individuals:

- Self-employed individuals
- 2% S corporation shareholders
- 5% C corporation shareholders
- Individuals related to the employer (e.g., your dependent)

TABLE 7.4 Food Rates for Day Care Providers for 2010

Location	Breakfast	Lunch/Supper	Snacks
Continental U.S.	$1.19	$2.21	$0.66
Alaska	1.89	3.59	1.07
Hawaii	1.38	2.59	0.77

If you claim a credit, you must reduce the deduction for health insurance premiums by the amount of the credit.

Starting in 2014, a new credit applies, but only for insurance purchased through a health care exchange, which has yet to be set up. The new credit can be claimed only for a maximum of two years.

Meal Allowance for Day Care Providers

If you care for children or others in your home, you can deduct the actual cost of providing meals and snacks to them. Alternatively, you can use a standard food program reimbursement rate set by the U.S. Department of Agriculture. The rates in effect for 2010 can be found in Table 7.4.

The rates for 2011 can be found in Table 7.5. Knowing these rates in advance can help you set your fees for day care services in 2011.

PLANNING

Keep good records of the food you provide (without itemizing allocations for each individual in your care). You can deduct up to one breakfast, one lunch, one supper, and three snacks per day per child or other person, if your records show that you serve them.

TABLE 7.5 Food Rates for Day Care Providers for 2011

Location	Breakfast	Lunch/Supper	Snacks
Continental U.S.	$1.19	$2.22	$0.66
Alaska	1.89	3.60	1.07
Hawaii	1.38	2.60	0.77

Qualified Disaster Costs

If your business suffered property damage because of an event declared to be a federal disaster, you may qualify for special tax treatment. Instead of capitalizing certain costs related to a federally declared disaster, you can opt to deduct (i.e., expense) the costs when they are paid or incurred.

Expenses eligible for this deduction include costs for the abatement or control of hazardous substances released on account of the disaster, the removal of debris from structures or the demolition of structures damaged by the disaster, and the repair of business-related property damaged by the disaster.

This expensing deduction effectively is treated as a depreciation allowance because it reduces the basis of the property and is subject to recapture when the property is sold or otherwise disposed of.

Alert

This election to deduct costs applies only to disasters declared after December 31, 2007, and before January 1, 2010, unless it is extended. Check the Supplement for details.

Energy Credits

There are several business-related energy credits to which you may be entitled. The credits are highly complex, so you may need the help of an energy expert.

The energy credits are subject to the general business credit limitations discussed earlier in this chapter (see “Plug-in Electric Vehicles”).

W-2 Forms

If you have an employee (even if you’re the only employee of your corporation), each year you must provide Form W-2 to the worker (and a copy of it to the Social Security Administration). The rules for reporting wages and other benefits earned by workers in 2010 have not changed.

Starting in 2011, the W-2 form will have to include the value of health coverage, whether such cost is paid by the employer, the employee, or both. Work with your insurer to determine this amount.

In 2013 and later years, employers who provide health coverage will have to report this to the IRS. The way in which this will be done has yet to be determined.

Also in 2013, employers will have to withhold the additional Medicare tax on employees earning more than $200,000. However, for their married employers, they are not required to ask about spousal earnings (which ultimately impact the employee's additional Medicare tax).

Simple Cafeteria Plans

Cafeteria plans can be used by a small business to offer a menu of benefits to employees, allowing them to choose the ones they value the most. Starting in 2011, small employers can set up cafeteria plans for their staff under which the complex nondiscrimination rules of classic cafeteria plans are met automatically.

Small cafeteria plans are open only to employers with 100 or fewer employees. However, an employer that grows the payroll can continue to use a small cafeteria plan until there are 200 or more employees on staff.

To qualify as a simple cafeteria plan, employer contributions to the plan must be at least equal to:

- A uniform percentage (but not less than 2 percent), or
- An amount not less than (1) 6 percent of the employee's compensation for the plan year, or (2) twice the amount of the salary reduction contribution of each employee.

PLANNING

Look for the IRS to provide guidance on these plans.

Additional Medicare Tax

Starting in 2013, there is an additional Medicare tax of 0.9 percent on the self-employment of certain high-income taxpayers. The additional tax is imposed on self-employment income in excess of $200,000 for singles, $250,000 for joint filers, and $125,000 for married persons filing separately. The additional tax also is imposed on wages of an employee (discussed in Chapter 5).

Usually, the Medicare tax is levied on each person separately. However, the additional Medicare tax is imposed on the combined self-employment income and/or wages of a married couple filing jointly. While one-half of self-employment tax is a deduction from gross income, this does *not* include the additional Medicare tax. There is another additional Medicare tax on investment income. This additional tax is explained in Chapter 4.

PLANNING

If you have to pay the additional Medicare tax, be sure to take it into account in figuring wage withholding or estimated tax payments so you avoid estimated tax penalties.

Making Work Pay Credit

There is a tax credit for 2009 and 2010 called the Making Work Pay credit. It is a personal tax credit, not a business credit, that you earn because you have earned income from your business.

The credit is 6.2 percent of earned income, up to a maximum of $400 for singles and $800 for joint filers per year.

Basic eligibility rules and the modified adjusted gross income cap applicable to both employees and self-employed individuals are discussed in Chapter 5.

Payment Method

Because self-employed individuals do not receive a paycheck (regardless of the fact that they may take withdrawals from their company's bank account), they cannot enjoy the credit through increased take-home pay. Instead, self-employed individuals have two ways of receiving the credit:

1. Reduce estimated taxes for the year to reflect the credit amount they expect to be entitled to.
2. Claim the credit on the tax return when it is filed. For example, the Making Work Pay credit for 2010 can be claimed on the 2010 return when it is filed in 2011.

Schedule M

The credit is figured on Schedule M, *Making Work Pay Credit,* which is part of Form 1040. The form is used to ensure that you obtain the full amount of the credit you're entitled to.

Self-Employment Tax

Employees cover their Social Security and Medicare tax obligation through the payment of FICA; their employer pays a like amount on their behalf. Self-employed individuals must pay *both* the employee and employer share; this is called self-employment tax.

The tax rates on the Social Security and Medicare portions of self-employment tax remain unchanged for 2010. The Social Security tax rate is 12.4 percent and the basic Medicare tax rate is 2.9 percent. These basic rates remain the same year after year.

The wage base limit on which the Social Security portion of self-employment tax is figured is limited to $106,800 in 2010, the same as it was in 2009. There is no wage base limit for the Medicare portion of the tax. If you have both a job and self-employment income, you use a single wage base for the Social Security portion; you pay Medicare tax on both your wages and self-employment income.

Optional Method

If 2010 is a bad year, profit-wise, you may wish to use the optional method to figure your net earnings so you make a contribution to Social Security.

If you're a self-employed individual with nonfarm income, you can use the optional method only if:

- Your net nonfarm profits were less than $4,851 in 2010 and also less than 72.189 percent of your gross nonfarm income.
- You had net earnings from self-employment of at least $400 in two of the three prior years.

Once you determine you are eligible to use the optional method, then your self-employment tax is the smaller of (1) two-thirds of gross nonfarm income (but not less than zero) or (2) $4,480.

If you have income from farming, there is a different optional method that applies to you (see Part II of Schedule SE, *Self-Employment Tax,* of Form 1040).

Deduction for Self-Employment Tax

One-half of the self-employment tax you pay is deductible from gross income. It is a personal deduction that you can claim whether or not you itemize your other personal deductions.

The additional Medicare tax (explained above), which applies starting in 2013, is not one-half deductible.

Health Insurance Premiums

Self-employed individuals can deduct their health insurance premiums as an adjustment to gross income and not as a business deduction (premiums paid for staff are a business deduction). However, for 2010, the premiums can reduce net earnings from self-employment for purposes of the self-employment tax. For a self-employed person who pays $10,000 in premiums to cover him- or herself, spouse, and dependents, this saves about $1,500 in self-employment tax.

START-UP COSTS

If you start a business in 2010, you may be able to write off this year some or all of the costs you paid before you opened your doors. Before 2010, start-up costs could be deducted up to $5,000, with excess costs deducted ratably over 180 months (15 years). If start-up costs topped $50,000, then the $5,000 limit was reduced dollar for dollar by each dollar of start-up cost over $50,000. For 2010, the dollar limits have been increased: $10,000 can be deducted in the business' first year, with a $60,000 threshold for the phaseout (i.e., all costs must be deducted ratably over 180 months if total start-up costs exceed $70,000).

GENERAL BUSINESS CREDIT CARRYBACKS

Many of the business credits, such as the disabled access credit and the credit for starting up retirement plans, are components of the general business credit. The general business credit operates as an overall limit on the total that can be claimed for the year. The general business credit cannot exceed the excess of net income over the greater of tentative minimum tax or 25 percent of regular

tax liability over $25,000. Ordinarily, unused credits (amounts in excess of the limit) can be carried back for one year and forward for up to 20 years.

For credits in 2010 of eligible small businesses, there is a five-year carryback period. Eligible small businesses include sole proprietors (as well as privately held corporations and partnerships) with average annual gross receipts in the three prior years not exceeding $50 million. The carryback may create tax refunds for these prior years, giving you cash to use now.

CHAPTER 8

Estate, Gift, and Generation-Skipping Transfer Taxes

While much of the focus of this book has been on income taxes (with a little attention given to Social Security and Medicare taxes), don't ignore the other taxes that may affect your financial picture. These include estate, gift, and generation-skipping transfer taxes. In 2010, there were dramatic changes affecting each of these taxes, which are levied on transferring wealth.

This chapter explains the changes in these transfer taxes for 2010 and what may lie ahead. This area of tax law is about to experience additional changes that certainly will affect your estate planning for years to come. There also may be state estate or inheritance taxes to deal with; state-level taxes are not covered in this chapter but should be discussed with your financial advisor.

Estate Tax Changes

If your property (called your "estate") at the time of your death is worth a certain amount, your estate usually has to file a federal estate tax return and your estate may owe federal estate taxes on the value of your assets. However, for 2010, there was no federal estate tax. This means that the estates of wealthy individuals who died in 2010 escape any federal estate tax. Wealthy individuals who died in 2010 include George Steinbrenner (owner of the New York Yankees),

JD Salinger (novelist), Dan Daniels (energy magnate), Walter Shorenstein (real estate developer), Glen Bell (founder of Taco Bell), Art Linkletter (TV host), Dennis Hopper (actor), and Louis Auchincloss (novelist).

Throughout 2010, there had been talk of instituting a federal estate tax for the year, but as time went on and Congress failed to act, it became unlikely that any change for the year would be created. Many argued that any retroactive imposition of an estate tax would be unconstitutional.

However, after 2010, the estate tax rules in effect prior to 2002 are scheduled to reappear. Under these rules, each person had an estate tax exemption of $675,000 in 2001, which had been scheduled to rise to $1 million by 2006. Assuming the $1 million exemption amount (with a unified credit amount of $345,800) becomes applicable in 2011, then a married couple could pass $2 million tax free to their children, or anyone else. Graduated estate tax rates up to a high of 55 percent are set to apply.

If you're married, you can arrange it so that the estate tax may be postponed until the death of whichever spouse dies second, but eventually some transfer tax will be paid if the value of assets remaining at the death of the second spouse exceeds a certain amount.

Alert

Estate tax rules for 2011 could be changed. Check the Supplement for details.

Exemption Amount

How "rich" do you have to be in order to be concerned about the federal estate tax? That figure increased dramatically from $675,000 in 2002 to $3.5 million in 2009.

This exemption is accomplished by permitting an estate to claim a tax credit (called the unified credit) against the tax liability that effectively. Thus, in 2009, the tax credit reflecting the $3.5 million exemption amount was a unified credit of $1,455,800.

As mentioned earlier, in 2010, there is no exemption amount because there is no federal estate tax. The estate of anyone dying in 2010, whether he or she is a billionaire or middle-income person, is entirely free of federal estate tax.

Starting in 2011, the old federal estate tax rules that had applied prior to the 2001 Tax Act are scheduled to reappear. However, it is likely that Congress will change the estate tax rules. Exemption amounts for 2011 could be fixed at $3.5 million (the amount that applied in 2009), $5 million, or more; the exemption amounts are indexed annually for inflation.

PLANNING

Regardless of what the exemption is set at in 2011, don't be too quick to dismiss the federal estate tax out of hand because you think the rules don't apply to you—the size of your estate may be larger than you think. In adding up your estate, be sure to consider *all* your assets, including your IRAs (including Roth IRAs) and retirement benefits and inheritances you may come into. By making a thorough inventory of your assets (based on their present value), you'll get a better idea of whether you should be planning to reduce federal estate taxes or whether you're home free. Just remember that things can change—you may think you're currently exempt from worrying about the federal estate tax but if you come into money (e.g., an insurance settlement, lottery winnings, or an inheritance), you may find yourself vulnerable to the federal estate tax. Or if the value of your assets rises (e.g., the stock market recovers and the value of your stocks and stock mutual funds held both personally and in retirement accounts increases), again you may find that the size of your estate is large enough to fall victim to estate tax—or at least the need to plan to minimize or avoid it.

Until now, a common estate-planning strategy for married couples with sufficient assets to be subject to the federal estate tax was to set up a credit shelter or by-pass trust so that the exemption amount could be fully used in the estate of the first spouse to die. It worked like this: A will provided that a credit shelter trust (also called a by-pass trust) would be created with an amount equal to the maximum exemption amount. The surviving spouse would be named as the income beneficiary of that trust, enjoying income for life (and some principal if necessary to maintain the surviving spouse's lifestyle), with assets of the trust passing at the surviving spouse's death to other named beneficiaries (typically the couple's children). Assets in excess of the exemption amount placed in the trust would pass outright to the surviving spouse. Result: At the death of the first spouse there would be no estate tax—the assets passing directly to the surviving spouse would be shielded by the marital deduction and the assets passing into the credit shelter trust would be shielded by the exemption amount. At the

death of the surviving spouse, the assets in the trust would not be included in his or her estate—they pass directly (untaxed) to the named beneficiaries.

If your existing will or a trust contains a formula clause for funding a credit shelter or by-pass trust based on the "maximum federal exemption amount" or "maximum unified credit," you may wish to revise these documents, depending on the size of your estate and the exemption amount fixed for next year and years to come. You may be passing on to that trust more than you intended, to the detriment of other heirs. For example, if your estate is $3.7 million and the exemption amount is fixed at $3.5 million for the year in which you die, the credit shelter trust based on the maximum exemption amount ($3.5 million) would absorb almost your entire estate—this may be more than you'd envisioned.

Discuss with your tax or legal advisor new ways to limit the amount of assets passing into a credit shelter or by-pass trust. For example, you may wish to limit the funding of a credit shelter trust to a set dollar amount or a percentage of the estate, or some combination of these two limits.

Most important, you'll want to review any current estate plans in light of estate tax changes that may be enacted for 2011 and future years.

Miscellaneous Estate Tax Changes

There are a number of changes that can affect the computation of the federal estate tax. Some of these changes are minor or merely technical in nature, but others can have a significant impact on the amount of taxes that will be paid by an estate.

Special Use Valuation

If an estate includes a farm or property used in a business, it can be valued for estate tax purposes at its special use rather than at its highest and best use (assuming certain conditions are met). However, the reduction in the size of the gross estate through special use valuation cannot exceed a set dollar amount. The amount of the exemption for 2011 is unknown at this time; it was $1 million for 2009.

Interest on the Portion of the Estate Tax Payable in Installments

Certain estates can qualify to pay federal estate tax in installments over 14 years. This payout option is designed to permit estates heavily composed

of business interests to avoid liquidating those interests (often at fire sale prices) to pay the estate tax.

If the estate is eligible and elects this installment payment option, then a portion of the federal estate tax is subject to a favorable interest rate of only 2 percent. The dollar amount used to determine the 2 percent portion increased in 2010 to $1,340,000 (up from $1,330,000 in 2009).

This figure will be adjusted for inflation in 2011, although with inflation low, there may be little or no increase.

Basis of Inherited Assets

If your heirs inherit your property, they are impacted by "basis" when they eventually sell the property. Basis for income tax purposes typically is cost—what you pay to acquire property. For inherited assets, however, different rules apply.

Stepped-up Basis

Usually, heirs use a "stepped-up basis" for property inheritances. This means that their basis for an asset is determined by its value for estate tax purposes. It does not matter what the deceased person paid for the asset. Estate tax value typically is the value on the date of death. However, if the estate opts to value assets on the alternate valuation date, which is six months after the date of death, then the value on this alternate valuation date controls. If an estate is not required to file an estate tax return because it is too small, then the value of the assets on the date of death determines the tax basis for the heir.

Example

In 2009, you inherit stock from your aunt that was valued in her estate at $10,000. In 2010, you sell it for $14,000. Your gain is $4,000 ($14,000 proceeds less your basis of $10,000).

Modified Carryover Basis

For property inherited from a decedent who dies in 2010, there is a "modified carryover basis rule" used to determine the basis of an heir's assets. Carryover

means that the heir effectively steps into the shoes of the deceased person, taking over his or her basis in the assets.

Example

In 2010, you inherit stock from your aunt that was valued in her estate at $10,000. She purchased the stock several years ago for $2,000 and the executor of her estate tells you that your basis under the carryover basis rules is $2,000 (her basis). If you sell the stock in 2011 for $14,000, your gain will be $12,000 ($14,000 proceeds less your basis of $2,000).

However, the rule is "modified" because there are two important exemptions that allow the stepped-up basis rules to apply to certain property:

- $3 million of the value of property passing to a surviving spouse who is a U.S. citizen (there is a smaller exemption for a non-U.S. citizen spouse)
- $1.3 million of the value of property passing to anyone else

It is up to the executor of the estate to decide which property the exemptions will be applied to.

Types of property subject to the modified carryover basis rule:

- Property acquired by bequest, devise, or inheritance
- Property acquired from a decedent's estate
- Property transferred by the decedent during his or her lifetime to a revocable living trust
- Property transferred by a decedent during his or her lifetime to a trust in which he or she had the right to income for life and reserved the right at all times before death to make changes to the enjoyment of the trust through the exercise of a power to alter, amend, or terminate the trust
- Property passing from the decedent by reason of his or her death without any payment on the part of the recipient (e.g., property passing to a joint tenant under rights of survivorship)
- The surviving spouse's one-half interest in community property (for those in community property states)

Types of property not subject to the modified carryover basis rule (and automatically given stepped-up basis):

- Property obtained by the decedent as a gift within three years of death
- Property that is income in respect of a decedent (income earned by the decedent before death but payable after death)
- Stocks and other securities in foreign personal holding companies

Alert

At the time of preparation of this book, the IRS had not provided any guidance on the modified carryover basis rule. Some experts had speculated that the rule would be repealed along with the reinstitution of the estate tax rules for 2010, but thus far this has not occurred. Check the Supplement for details.

PLANNING

If you inherit property in 2010 with a carryover basis, be sure to obtain the deceased person's basis information from the executor of the deceased person's estate. Keep this information because you'll need it when you sell the property.

If you inherit property with a carryover basis and you hold it until your death, your heirs will get a stepped-up basis. The modified carryover basis rule applies only to property inherited from someone who died in 2010.

Gift Tax Changes

You probably know that giving or receiving a gift has no impact for income tax purposes. Someone can give you a small birthday gift or a $1 million gift and you won't pay any income tax on the gift; the giver doesn't pay any income tax either.

Gift tax, however, is another story. Gift tax is a tax that can be imposed on the giver (called the "donor"). More than a quarter of a century ago, the estate and gift taxes were unified, meaning they were subject to the same tax rates and the same exemption amount. Then, starting in 2002, they were decoupled, so that different rates and exemption amounts apply. Looking ahead beyond 2010, the estate and gift taxes could again be unified, but no one knows for sure as yet.

For 2010, the gift tax continues to apply even though there is no federal estate tax. The gift tax rate on taxable gifts (above the annual exclusion and lifetime exemption, explained below) is a flat 35 percent.

Annual Gift Tax Exclusion

Each year you can give away a set amount to as many people as you choose without any gift tax—without even having to file a gift tax return, if the gift to each person does not exceed an annual exclusion amount.

In 2010, the annual exclusion is $13,000 per beneficiary (the same as it was for 2009). Thus, you can give away $13,000 to as many people as you wish. If you keep all of your gifts under the annual exclusion amount, you don't even have to tell the IRS about it; no gift tax return is required in this case.

The annual exclusion may be adjusted for inflation for 2011. However, given the low rate of inflation, there may be little or no adjustment to the $13,000 exclusion.

Example

In 2010, you can give each of your four grandchildren $13,000 cash. Your gifts totaling $52,000 are tax free.

Married couples can agree to make split gifts, thereby doubling the annual gift tax exclusion. In other words, together they can give any person $26,000 in 2010—even if the gifted money or property is owned by one spouse. However, if split gifts are made, a gift tax return must be filed—even though no tax is due.

Example

In 2010, a husband gives each of his four grandchildren $26,000 in cash. His gifts total $104,000. If his wife agrees to split the gifts, even though they were made with his money, there is no gift tax. The couple, however, must file a gift tax return to report the split gifts.

For purposes of the annual exclusion, gifts of property are based on the value of the property on the date of the gift. For example, if you give shares of XYZ

stock to your child on December 1, 2010, determine their value on December 1 (not what you paid for the stock) to see whether the value of the shares is no more than the annual exclusion.

PLANNING

If you can give away cash or property without any concern that the transfer may impact your standard of living today or in the future, you may wish to adopt a gifting program as a means of benefiting your loved ones today, saving income taxes, and cutting your future estate taxes. Consider these strategies:

- You can make an unlimited amount of direct payments to a school or medical provider for the same beneficiary. For example, you can give your grandchild $13,000, and pay his tuition to college of $30,000 by writing a check directly to the college.
- You can fund a beneficiary's 529 plan using five times the annual gift tax exclusion, or $65,000 in 2010. This gift is treated as having been made to the beneficiary in equal amounts over five years, so no additional gift can be made to the same beneficiary within the five-year period if your 529 plan contribution is $65,000 or more.
- You can shift income to family members in a lower tax bracket to save taxes for the family. For example, if you are in a tax bracket of 25 percent or higher but your elderly parent is in the 15 percent tax bracket, a transfer of dividend-paying stock or mutual fund shares could enable your parent to receive the dividends tax free (if Congress retains the favorable tax treatment on dividends for taxpayers in the lowest tax brackets). If you own appreciated property, such as a stock or bond, rather than giving cash gifts, consider giving the property to such relative before the end of 2010, followed by a sale of the property by the relative. The sale of the appreciated property will be tax free in 2010 as long as the relative is in the 10 percent or 15 percent tax bracket for 2010 (there is no capital gain tax levied on such person in 2010).
- You can combine the annual gift tax exclusion with your lifetime exemption amount (explained below). Thus, even though an annual gift exceeds the exclusion, it does not necessarily mean that you'll owe any gift tax.

The exclusion is a use-it-or-lose-it break; you cannot "bank" the exclusion for a later year. If you give your child only $5,000 this year, for example, you can't add the unused $8,000 of the exclusion to your 2010 exclusion (for a gift to your child next year).

Lifetime Gift Tax Exemption Amount

You may give away in your lifetime a set amount without any gift tax. For 2010, the gift tax exemption amount is $1 million (the same as it has been for a few years). It is not indexed for inflation. The exemption amount translates into a tax credit of $345,800.

Gifts to Non-U.S. Citizen Spouses

While gifts to spouses who are U.S. citizens can be made in any amount—there is no percentage or dollar limit—a dollar limit is imposed on transfers to non-U.S. citizen spouses (including spouses who are permanent U.S. residents). In 2010, the limit increases to $134,000, up from $133,000 in 2009.

Generation-Skipping Transfer Tax Changes

Wealthy individuals whose children don't need an inheritance to improve their standard of living may give their money directly to their grandchildren, skipping over the intervening generation of the children. This strategy effectively saves estate tax on one generation (the children's generation), allowing grandchildren to inherit more property on an after-tax basis. Making a generation-skipping transfer—from grandparent to grandchild—may result in a special transfer tax, called the generation-skipping transfer (GST) tax. The GST tax is a way for the government to collect the revenue that otherwise would be lost by avoiding estate tax on the skipped generation. The GST tax is imposed in addition to any other transfer tax (estate or gift tax).

Since the GST is tied to the estate tax rules, there is no GST for 2010.

Alert

The generation-skipping transfer tax is poised to return in 2011 (see discussion of estate tax above). Check the Supplement for details.

GST Exemption Amount

The exemption amount that can be transferred across the generations without imposition of the GST tax is the same as the estate tax exemption amount. Check to see what Congress does about the estate tax exemption in order to determine what the GST exemption will be for 2011.

APPENDIX A

Expiring Laws

According a report from the Joint Committee on Taxation, there are 69 provisions expiring in 2010 and a handful of other provisions set to expire in 2011. Some may be extended unchanged while others may be extended with modifications. Following are some of the key provisions to note, their expiration dates, and the likelihood of action so you can include these provisions in your tax plans. They are organized according to the chapters to which they relate.

Chapter 1: Your Home and Family

Homebuyer credit. The credit is up to $8,000 for first-time homebuyers and $6,500 for long-term residents. The likelihood of any extension is small. *Expiration date: April 30, 2010 (although those in contract on this date had until September 30, 2010 to close).*

Premiums for mortgage insurance. The treatment of mortgage insurance premiums as deductible mortgage interest is likely to be extended. *Expiration date: December 31, 2010.*

Home energy improvements. The credit for adding insulation, storm windows, and certain other approved property to a main residence could be

extended, but this is not certain. The credit had been allowed to lapse for 2008. *Expiration date: December 31, 2010.*

Exclusion for benefits to emergency responders. The exclusion for property tax breaks received by volunteer firefighters and emergency medical responders could be extended, although there is no indication that it will be. *Expiration date: December 31, 2010.*

Earned income credit. The enhanced credit for those with three or more qualifying children and the marriage penalty relief could be extended. *Expiration date: December 31, 2010.*

Dependent care credit. The expanded credit will revert to modest amounts, but the favorable rules could be extended. *Expiration date: December 31, 2010.*

Adoption credit. The increased credit amount and refundability will expire; this could be extended. *Expiration date: December 31, 2011.*

Child tax credit. The increased credit amount as well as the refundable floor amount will expire, but could be extended. *Expiration date: December 31, 2010.*

Marriage penalty relief. Breaks that include a doubling of the standard deduction for joint filers to twice the amount for single filers, as well as a doubling of the 15 percent tax bracket, are set to expire. *Expiration date: December 31, 2010.*

Reduction in personal exemptions. The phaseout for high-income taxpayers of their personal exemptions, which no longer applied in 2010, will reapply thereafter unless extended. *Expiration date: December 31, 2010.*

Chapter 2: Health Care and Education

Enhanced credit for health insurance costs of certain displaced workers. The increased credit amount could be extended, but this is not certain. *Expiration date: December 31, 2010.*

COBRA subsidy. The federal government's payment of 65 percent of an involuntarily terminated worker's COBRA premiums for 15 months likely will *not* be extended. *Expiration date: Workers terminated after April 30, 2010.*

American Opportunity tax credit. This credit, of up to $2,500 for tuition and other qualified expenses for the first four years of higher education, replaced the Hope credit for two years; it could become a permanent replacement. *Expiration date: December 31, 2010.*

529 plan distributions for computer technology. The exclusion for disbursements from 529 plans to pay for computer technology and equipment could be extended. *Expiration date: December 31, 2010.*

Student loan interest deduction. More restrictive rules are set to reappear after 2010 unless the more liberal rules are extended. *Expiration date: December 31, 2010.*

Coverdell education savings accounts (ESAs). The rules for these savings plans will change dramatically after 2010, reverting to old, more restrictive rules that limit annual contributions to $500 and qualified distributions to postsecondary schools, and tax even qualified distributions. *Expiration date: December 31, 2010.*

Chapter 3: Retirement Planning

There are no scheduled expirations related to retirement planning.

Chapter 4: Investment Opportunities

Capital gains rate. The top basic capital gains rate for individuals of 15 percent (zero for those in the 10 percent or 15 percent tax bracket) is set to expire at the end of 2010. It is possible that the favorable rates will be retained for all but “high-income” taxpayers. *Expiration date: December 31, 2010.*

Exclusion for small business stock. Gain on stock issued after September 27, 2010, and before January 1, 2011, is not taxed because of a 100 percent exclusion; stock issued after December 31, 2010, has a 50 percent exclusion unless the 100 percent (or 75 percent exclusion that had applied after February 17, 2009, and before September 28, 2010) is extended. *Expiration: December 31, 2010.*

Dividends. Qualified dividends are taxed at favorable capital gains rates through the end of 2010; thereafter dividends will be taxed as other ordinary income. It is possible that the favorable treatment for qualified dividends will be retained for most taxpayers. *Expiration date: December 31, 2010.*

Chapter 5: Your Job

Making Work Pay credit. The $400 ($800 on a joint return) credit for workers was created to stimulate the economy. Whether the credit will run beyond 2010

depends on the state of the economy at that time. *Expiration date: December 31, 2010.*

Transportation benefits. The parity for monthly transit passes with free parking could be extended. *Expiration date: December 31, 2010.*

Employer-paid graduate school costs. Educational assistance plans can cover graduate school through 2010; only undergraduate school will be covered after 2010 unless the break is extended. *Expiration date: December 31, 2010.*

Chapter 6: Miscellaneous Changes

Tax brackets. The 10 percent bracket is set to expire at the end of 2010. The doubling of the 15 percent tax bracket for joint filers to twice the amount for single filers ("marriage penalty relief") also is set to expire at the end of 2010. The top two tax brackets of 33 percent and 35 percent are set to revert to their former limits of 36 percent and 39.6 percent. While the 10 percent bracket may be retained, it is unlikely that the top two brackets will be retained. *Expiration date: December 31, 2010.*

Reduction in itemized deductions. The phaseout for high-income taxpayers of itemized deductions, which no longer applied in 2010, will reapply thereafter unless extended. *Expiration date: December 31, 2010.*

Credit for hybrid vehicles. This credit for purchasing a new hybrid vehicle is set to expire and likely will *not* be extended. *Expiration date: December 31, 2010.*

Chapter 7: Your Business

First-year expensing. The $500,000 limit could be extended; if it is not, then the former $25,000 limit adjusted for inflation will reapply. *Expiration date: December 31, 2011.*

Bonus depreciation. The 50 percent bonus depreciation allowed for new equipment purchases in 2010 could be extended, as it has been in the past. *Expiration: December 31, 2010.*

Work opportunity credit. The targeted groups (unemployed veterans and disconnected youths) could be extended. *Expiration date: December 31, 2010.*

The credit itself is set to expire, but could be extended. *Expiration date: August 31, 2011.*

Payroll tax holiday. The waiver of the 6.2 percent Social Security portion of FICA on wages of certain newly hired employees is set to expire. *Expiration date: December 31, 2010.*

Health insurance premiums. Premiums of self-employed individuals can reduce net earnings from self-employment tax only for 2010. Small business advocates favor making the premiums a permanent business deduction. *Expiration: December 31, 2010.*

Start-up costs. The $10,000 dollar limit for start-up costs that can be deducted in 2010 is set to revert to $5,000 in 2011; the higher dollar limit could be extended. *Expiration: December 31, 2010.*

General business credit carryback. The longer carryback for the amount in excess of the general business credit limit is only for credits of eligible small businesses in 2010; the longer carryback period could be extended. *Expiration: December 31, 2010.*

Chapter 8: Estate, Gift, and Generation-Skipping Transfer Taxes

Estate tax. The temporary repeal of estate tax will end and estate tax again will apply starting in 2011, based on pre-2002 rules. It is likely that there will be a revised estate tax created for 2011 and later years. *Expiration date: December 31, 2010.*

Carryover basis. The modified carryover basis rule for 2010 inheritances will be replaced by stepped-up basis for inheritances after 2010. *Expiration date: December 31, 2010.*

Credit for state death taxes. Currently, estates may deduct state death taxes from federal estate taxes; after 2010, the deduction will be replaced by the former credit. *Expiration date: December 31, 2010.*

Gift tax rate. The current 35 percent tax rate on taxable gifts will expire. *Expiration date: December 31, 2010.*

Generation-skipping transfer tax. The temporary repeal of this tax will expire and former tax rules will apply unless new tax rules are enacted. *Expiration date: December 31, 2010.*

APPENDIX B

Online Planning Tools

Throughout this book you have seen various strategies you can use to optimize your tax savings in light of new law changes and potential changes. In order to help you make "what-if" calculations, there are a number of online tools that you can use for free. Here is a list of some helpful resources to make tax planning a little easier.

Chapter 1: Your Home and Family

Tax savings from mortgages. Interest on your mortgage (for a principal residence and a second home) is tax deductible (limits apply). Find out how much tax savings you realize as a result of your mortgage payments.

(http://finance.yahoo.com/calculator/taxes/hom09)

Earned income credit help. Are you eligible for the earned income tax credit? Using the IRS's "EITC assistant" you can find out if you qualify. The assistant is an interactive online conversation (not a calculator per se).

(www.irs.gov/individuals/article/0,,id=130102,00.html)

Chapter 2: Health Care and Education

Health savings account growth. How much can you expect to accumulate in a health savings account?

(www.dinkytown.net/java/HSASavings.html)

(www.hsacenter.com/future-savings-calculator.php)

Saving for college. How much do you need to put away for your child's college education, based on your child's current age, assumptions about investment return, and other factors? A very simple calculator can show you how much.

(www.bankrate.com/calculators/savings/saving-for-college-calculator.aspx)

(www.savingforcollege.com/college-savings-calculator)

Chapter 3: Retirement Planning

Roth IRA conversion calculator. Thinking of converting your traditional IRA to a Roth IRA? Does it make sense for you? Use a calculator to help make a decision. There are a number of calculators available.

(http://finance.yahoo.com/calculator/retirement/qua04)

(www.archimedes.com/vanguard/roth/RothConsumer.phtml)

(www.bankrate.com/calculators/retirement/convert-ira-roth-calculator.aspx)

(www.calcxml.com/do/qua04)

(www.schwab.com/public/schwab/planning/retirement/iras/roth_ira/roth_ira_conversion/considerations/roth_conversion_calculator)

401(k) calculator. Determine what impact an increase in elective deferrals can have on your retirement savings.

(http://finance.yahoo.com/calculator/career-work/pay08)

Chapter 4: Investment Opportunities

Taxable versus tax-exempt bond yields. Compare the after-tax cost of owning taxable bonds with that of tax-exempt bonds to help you decide which are better investments for you (after factoring in your filing status, overall income, and state income tax rate).

(www.dinkytown.net/java/TaxEquivYield.html#calc).

(www.investinginbonds.com/calcs/taxcalculator/taxcalcform.aspx)

Chapter 5: Your Job

Wage withholding calculator. Figure income tax withholding from your paycheck in light of eligibility for tax breaks discussed throughout the book.
(www.irs.gov/individuals/article/0,,id=96196,00.html?portlet=4)

Impact of adjustment on your paycheck. If you increase contributions to a 401(k), reduce withholding allowances, or make other changes, the size of your take-home pay will change. See how adjustments affect you.
(http://finance.yahoo.com/calculator/career-work/pay02)

W-4 assistant. How many withholding allowances should you claim on Form W-4, which tells your employer how much income tax should be withheld from your paycheck? Use an online calculator to figure both federal and state withholding.
(www.paycheckcity.com/W4/w4instruction.asp)

Chapter 6: Miscellaneous Changes

Impact of the expiration of Bush tax cuts. If the Bush tax cuts are allowed to expire at the end of 2010, how will this impact your tax bill for 2011? Use a special calculator from the Tax Foundation.
(www.mytaxburden.org)

AMT calculator. Are you subject to the alternative minimum tax? The IRS has a "tax assistant" to help you make this determination. This is an interactive online conversation (not a calculator per se) to help you learn about your AMT position. (At the time of publication, only the 2009 assistant was available because the 2010 exemption amounts had not yet been determined.)
(http://apps.irs.gov/app/amt2009/index.jsp?ck)

Chapter 7: Your Business

Estimated taxes. How much should you pay each quarter to satisfy estimated tax payments? In order to make this decision, you first have to project your total tax bill for the year. Then you can divide this by four and pay at least 90 percent to avoid estimated tax penalties.
(www.dinkytown.net/java/Tax1040.html)

Chapter 8: Estate, Gift, and Generation-Skipping Transfer Tax

Estate taxes. How much federal estate tax will your estate owe when you die? It's very difficult to make projections now because of uncertainty about federal estate tax rules. However, use an online calculator to make certain assumptions and projections.

(www.calcxml.com/do/inc01)

APPENDIX C

Forms and Worksheets

The following pages contain forms and worksheets referred to throughout the book.

Instructions: Use the following worksheet to figure the taxable portion of your COBRA premium if your modified AGI (line 3 below) is more than $125,000 ($250,000 if married filing jointly) but less than $145,000 ($290,000 if married filing jointly).

1.	Enter your AGI (Form 1040, line 38 or Form 1040NR, line 35)	**1.** ________
2.	Enter the total of any amounts from Form 2555, lines 45 and 50; Form 2555-EZ, line 18; and Form 4563, line 15, and any exclusion of income from American Samoa and Puerto Rico . . .	**2.** ________
3.	Modified AGI. Add lines 1 and 2	**3.** ________
4.	Enter $125,000 ($250,000 if married filing jointly)	**4.** ________
5.	Subtract line 4 from line 3	**5.** ________
6.	Enter $20,000 ($40,000 if married filing jointly)	**6.** ________
7.	Divide line 5 by line 6. Enter the result as a decimal (rounded to at least 3 places)	**7.** ___.____
8.	Enter the amount of the COBRA premium assistance* you received in 2009	**8.** ________
9.	Multiply line 8 by line 7. Enter result here and include it on Form 1040, line 60 or Form 1040NR, line 57. On the dotted line next to that line, enter the amount shown on line 9 and identify it as “COBRA.”	**9.** ________

***Contact your former employer or health insurance plan to obtain the total premium assistance, if unknown.**

EXHIBIT C.1 Recapture of COBRA Premium Assistance for High-Income Taxpayers

Form **982** (Rev. March 2009)
Department of the Treasury Internal Revenue Service

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

► **Attach this form to your income tax return.**

OMB No. 1545-0046
Attachment Sequence No. **94**

Name shown on return | **Identifying number**

Part I General Information (see instructions)

1 Amount excluded is due to (check applicable box(es)):
a Discharge of indebtedness in a title 11 case . . . . ☐
b Discharge of indebtedness to the extent insolvent (not in a title 11 case) . . . . ☐
c Discharge of qualified farm indebtedness . . . . ☐
d Discharge of qualified real property business indebtedness . . . . ☐
e Discharge of qualified principal residence indebtedness . . . . ☐
f Discharge of certain indebtedness of a qualified individual because of Midwestern disasters . . . . ☐
2 Total amount of discharged indebtedness excluded from gross income . . . . . . | 2 |
3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . . ☐ Yes ☐ No

Part II Reduction of Tax Attributes.

You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

		Line	Amount
4	For a discharge of qualified real property business indebtedness, applied to reduce the basis of depreciable real property	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9	Applied to reduce any net capital loss for the tax year of the discharge including any capital loss carryovers to the tax year of the discharge	9	
10a	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. *DO NOT use in the case of discharge of qualified farm indebtedness.*	10a	
b	Applied to reduce the basis of your principal residence. *Enter amount here ONLY if line 1e is checked*	10b	
11	For a discharge of qualified farm indebtedness, applied to reduce the basis of:		
a	Depreciable property used or held for use in a trade or business, or for the production of income, if not reduced on line 5	11a	
b	Land used or held for use in a trade or business of farming	11b	
c	Other property used or held for use in a trade or business, or for the production of income .	11c	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge .	13	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded $ ________________________ from its gross income for the tax year beginning ____________________________ , and ending ______________________________ . Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of ____ .
(State of incorporation)

Note. *You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.*

For Paperwork Reduction Act Notice, see page 5 of this form. Cat. No. 17066E Form **982** (Rev. 3-2009)

EXHIBIT C.2 Form 982

1.	Enter your modified AGI for Roth IRA purposes	**1.**	________
2.	Enter: • $166,000 if filing a joint return or qualifying widow(er), • $-0- if married filing a separate return and you lived with your spouse at any time in 2009, or • $105,000 for all others	**2.**	________
3.	Subtract line 2 from line 1	**3.**	________
4.	Enter: • $10,000 if filing a joint return or qualifying widow(er) or married filing a separate return and you lived with your spouse at any time during the year, or • $15,000 for all others	**4.**	________
5.	Divide line 3 by line 4 and enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000	**5.**	________
6.	Enter the lesser of: • $5,000 ($6,000 if you are age 50 or older, or $8,000 for certain employer bankruptcies), or • Your taxable compensation . . .	**6.**	________
7.	Multiply line 5 by line 6	**7.**	________
8.	Subtract line 7 from line 6. Round the result up to the nearest $10. If the result is less than $200, enter $200	**8.**	________
9.	Enter contributions for the year to other IRAs	**9.**	________
10.	Subtract line 9 from line 6	**10.**	________
11.	Enter the lesser of line 8 or line 10. This is your **reduced Roth IRA contribution limit**	**11.**	________

EXHIBIT C.3 Figuring Your Reduced IRA Deduction for 2010

SCHEDULE A (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Itemized Deductions

▶ Attach to Form 1040. ▶ See Instructions for Schedule A (Form 1040).

OMB No. 1545-0074
2010
Attachment Sequence No. 07

Name(s) shown on Form 1040 | Your social security number

Section	Line	Description			
Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.			
	1	Medical and dental expenses (see page A-1)	1		
	2	Enter amount from Form 1040, line 38 [2]			
	3	Multiply line 2 by 7.5% (.075)	3		
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4	
Taxes You Paid (See page A-2.)	5	State and local income taxes	5		
	6	Real estate taxes (see page A-3)	6		
	7	New motor vehicle taxes from line 11 of the worksheet on back (for certain vehicles purchased in 2009)	7		
	8	Other taxes. List type and amount ▶ ____________	8		
	9	Add lines 5 through 8		9	
Interest You Paid (See page A-4.) **Note.** Your mortgage interest deduction may be limited (see page A-4).	10	Home mortgage interest and points reported to you on Form 1098	10		
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-4 and show that person's name, identifying no., and address ▶ ____________	11		
	12	Points not reported to you on Form 1098. See page A-4 for special rules	12		
	13	Mortgage insurance premiums (see page A-4).	13		
	14	Investment interest. Attach Form 4952 if required. (See page A-5.) .	14		
	15	Add lines 10 through 14		15	
Gifts to Charity If you made a gift and got a benefit for it, see page A-6.	16	Gifts by cash or check. If you made any gift of $250 or more, see page A-6	16		
	17	Other than by cash or check. If any gift of $250 or more, see page A-6. You **must** attach Form 8283 if over $500	17		
	18	Carryover from prior year	18		
	19	Add lines 16 through 18		19	
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See page A-7.).		20	
Job Expenses and Certain Miscellaneous Deductions (See page A-7.)	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-7.) ▶ ____________	21		
	22	Tax preparation fees	22		
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶ ____________	23		
	24	Add lines 21 through 23	24		
	25	Enter amount from Form 1040, line 38 [25]			
	26	Multiply line 25 by 2% (.02)	26		
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-		27	
Other Miscellaneous Deductions	28	Other—from list on page A-8. List type and amount ▶ ____________		28	
Total Itemized Deductions	29	Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40		29	
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here . . . . ▶ ☐			

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 17145C **Schedule A (Form 1040) 2010**

EXHIBIT C.4 Schedule A

Schedule A (Form 1040) 2010 Page 2

Worksheet for Line 7—New motor vehicle taxes

Use this worksheet to figure the amount to enter on line 7.

(Attach to Form 1040.)

Before you begin: ✓ You cannot take this deduction if the amount on Form 1040, line 38, is equal to or greater than $135,000 ($260,000 if married filing jointly).

✓ See the instructions for line 7 on page A-3.

1	Enter the state and local sales and excise taxes you paid in 2010 for the purchase of any new motor vehicle(s) **after** February 16, 2009, and **before** January 1, 2010 (see page A-3)	1	
2	Enter the purchase price **(before taxes)** of the new motor vehicle(s)	2	
3	Is the amount on line 2 more than $49,500? ☐ **No.** Enter the amount from line 1. ☐ **Yes.** Figure the **portion** of the tax from line 1 that is attributable to the first $49,500 of the purchase price of each new motor vehicle and enter it here (see page A-3).	3	
4	Enter the amount from Form 1040, line 38	4	
5	Enter the total of any— • Amounts from Form 2555, lines 45 and 50; Form 2555-EZ, line 18; and Form 4563, line 15, and • Exclusion of income from Puerto Rico	5	
6	Add lines 4 and 5	6	
7	Enter $125,000 ($250,000 if married filing jointly)	7	
8	Is the amount on line 6 more than the amount on line 7? ☐ **No.** Enter the amount from line 3 above on Schedule A, line 7. **Do not** complete the rest of this worksheet. ☐ **Yes.** Subtract line 7 from line 6	8	
9	Divide the amount on line 8 by $10,000. Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000	9	.
10	Multiply line 3 by line 9	10	
11	**Deduction for new motor vehicle taxes.** Subtract line 10 from line 3. Enter the result here and on Schedule A, line 7	11	

Schedule A (Form 1040) 2010

EXHIBIT C.4 (*Continued*)

SCHEDULE M (Form 1040A or 1040)
Department of the Treasury
Internal Revenue Service (99)

Making Work Pay Credit

► Attach to Form 1040A or 1040. ► See separate instructions.

OMB No. 1545-0074
2010
Attachment Sequence No. 166

Name(s) shown on return | **Your social security number**

To take the making work pay credit, you must include your social security number (if filing a joint return, the number of either you or your spouse) on your tax return. A social security number does not include an identification number issued by the IRS. Only the Social Security Administration issues social security numbers.

You cannot take the making work pay credit if you can be claimed as someone else's dependent or if you are a nonresident alien.

Important: Check the "**No**" box on line 1a and see the instructions if:
- **(a)** You have a net loss from a business,
- **(b)** You received a taxable scholarship or fellowship grant not reported on a Form W-2,
- **(c)** Your wages include pay for work performed while an inmate in a penal institution,
- **(d)** You received a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan, or
- **(e)** You are filing Form 2555 or 2555-EZ.

1a Do you (and your spouse if filing jointly) have 2010 wages of more than $6,451 ($12,903 if married filing jointly)?
☐ **Yes.** Skip lines 1a through 3. Enter $400 ($800 if married filing jointly) on line 4 and go to line 5.
☐ **No.** Enter your earned income (see instructions) **1a**

b Nontaxable combat pay included on line 1a (see instructions) **1b**

2 Multiply line 1a by 6.2% (.062) **2**

3 Enter $400 ($800 if married filing jointly) **3**

4 Enter the **smaller** of line 2 or line 3 (unless you checked "Yes" on line 1a) **4**

5 Enter the amount from Form 1040, line 38*, or Form 1040A, line 22 . . **5**

6 Enter $75,000 ($150,000 if married filing jointly) **6**

7 Is the amount on line 5 more than the amount on line 6?
☐ **No.** Skip line 8. Enter the amount from line 4 on line 9 below.
☐ **Yes.** Subtract line 6 from line 5 . . . . **7**

8 Multiply line 7 by 2% (.02) **8**

9 Subtract line 8 from line 4. If zero or less, enter -0- **9**

10 Did you (or your spouse, if filing jointly) receive an economic recovery payment in **2010**? You may have received this payment in 2010 if you did not receive an economic recovery payment in 2009 but you received social security benefits, supplemental security income, railroad retirement benefits, or veterans disability compensation or pension benefits in November 2008, December 2008, or January 2009 (see instructions).
☐ **No.** Enter -0- on line 10 and go to line 11.
☐ **Yes.** Enter the total of the payments you (and your spouse, if filing jointly) received in **2010.** Do not enter more than $250 ($500 if married filing jointly) . . **10**

11 **Making work pay credit.** Subtract line 10 from line 9. If zero or less, enter -0-. Enter the result here and on Form 1040, line 63; or Form 1040A, line 40 . . . . **11**

*If you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico, see instructions.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 52903Q **Schedule M (Form 1040A or 1040) 2010**

EXHIBIT C.5 Schedule M

Form **5405**
(Rev. December 2010)
Department of the Treasury
Internal Revenue Service

First-Time Homebuyer Credit and Repayment of the Credit

► Attach to your 2009 or 2010 Form 1040, Form 1040NR, or Form 1040X.
► See separate instructions.

OMB No. 1545-0074
Attachment Sequence No. **58**

Note. Skip this page and complete page 2 if you are only filing this form to (1) report a disposition or change in use of your main home for which you claimed the credit in 2008 or 2009, or (2) pay an installment of the credit you claimed for a home purchased in 2008.

Name(s) shown on return	**Your social security number**

Part I General Information

A Address of home qualifying for the credit (if different from the address shown on page 1 of Form 1040 or Form 1040X)

B Date purchased (MM/DD/YYYY) (see instructions) . . . . ► ________

Note. If the date purchased is before May 1, 2010, go to line E. Otherwise, go to line C.

C If the date purchased is after April 30, 2010, and before October 1, 2010, did you enter into a binding contract before May 1, 2010, to purchase the home before July 1, 2010?

☐ **Yes.** Go to line E. See instructions for documentation to be attached.

☐ **No.** You cannot claim the credit. However, if you (or your spouse if married) are a member of the uniformed services or Foreign Service, or an employee of the intelligence community, see line D. If line D applies, check the box on line D and continue; otherwise, you cannot claim the credit.

D If you meet the following conditions, check here . . . . ► ☐

I (or my spouse if married) am a member of the uniformed services or Foreign Service, or an employee of the intelligence community, and was on qualified official extended duty outside the United States for at least 90 days during the period beginning after December 31, 2008, and ending before May 1, 2010. If I purchased the home after April 30, 2011, and before July 1, 2011, I entered into a binding contract before May 1, 2011, to purchase the home before July 1, 2011. See instructions.

E Did you purchase the home from a related person or a person related to your spouse (see instructions)?

☐ **No.** Go to line F.

☐ **Yes.** You cannot claim the credit. Do not file Form 5405.

F If you are choosing to claim the credit on your return for the year before the year in which you purchased the home, check here (see instructions) . . . . ► ☐

Part II Credit

1	Enter the purchase price of the new home (see instructions)	1		
2	Multiply line 1 by 10% (.10) and enter the result here	2		
3	If you qualify for the credit as (check the applicable box): ☐ A first-time homebuyer, enter $8,000 ($4,000 if married filing separately). A first-time homebuyer is an individual (and that individual's spouse if married) who has not owned another main home during the 3-year period ending on the purchase date and meets other requirements discussed in the instructions. ☐ A long-time resident, enter $6,500 ($3,250 if married filing separately). A long-time resident is an individual (and that individual's spouse if married) who has owned and used the same home as that individual's main home for any 5-consecutive-year period during the 8-year period ending on the purchase date of the new main home and meets other requirements discussed in the instructions. See instructions for documentation to be attached.	3		
4	Enter the smaller of line 2 or line 3. But: **(a)** if married filing separately, enter the smaller of line 3 or your share of the amount on line 2 (see instructions); or **(b)** if someone other than your spouse also purchased an interest in the home, enter the smaller of your share of the amount on line 3 or your share of the amount on line 2 (see instructions)	4		
5	Enter your modified adjusted gross income (see instructions)	5		
6	Enter $125,000 ($225,000 if married filing jointly)	6		
7	Is line 5 more than line 6? **No.** Skip lines 7 and 8. Enter -0- on line 9 and go to line 10. **Yes.** Subtract line 6 from line 5 and enter the result. If the result is $20,000 or more, stop here. You cannot take the credit. Otherwise, go to line 8	7		
8	Divide line 7 by $20,000 and enter the result as a decimal (rounded to at least three places) . .	8	.	
9	Multiply line 4 by line 8	9		
10	Subtract line 9 from line 4 and enter the result. This is your credit. Also enter this amount on your 2009 or 2010 Form 1040, line 67, or the appropriate line in the "Payments" section of Form 1040X	10		

You must attach a copy of the properly executed settlement statement (or similar documentation) used to complete the purchase (see instructions).

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11880I Form **5405** (Rev. 12-2010)

EXHIBIT C.6 Form 5405

Form 5405 (Rev. 12-2010) Page 2

Note. Skip this page if you are not filing this form to (1) report a disposition or change in use of your main home for which you claimed the credit in 2008 or 2009, or (2) pay an installment of the credit you claimed for a home purchased in 2008.

Name(s) shown on return	**Your social security number**

Part III **Disposition or Change in Use of Main Home for Which the Credit Was Claimed**

11 Enter the date you disposed of, or ceased using as your main home, the home for which you claimed the credit (MM/DD) . . . . ▶ ______ / 2010

12 If you meet the following conditions, check here . . . . ▶ ☐

I (or my spouse if married) am a member of the uniformed services or Foreign Service, or an employee of the intelligence community. I sold the home, or it ceased to be my main home, in connection with Government orders for qualified official extended duty service. No repayment of the credit is required (see instructions). Stop here.

13 Check the box below that applies to you. See the instructions for the definition of "related person."

a ☐ I sold (including through foreclosure or repossession) the home to a person who is not related to me and had a gain on the sale (as figured after reducing the basis of my home by the credit I claimed in 2008 or 2009). Go to Part IV below.

b ☐ I sold (including through foreclosure or repossession) the home to a person who is not related to me and did not have a gain on the sale (as figured after reducing the basis of my home by the credit I claimed in 2008 or 2009). No repayment of the credit is required. Stop here.

c ☐ I sold the home to a related person. Go to Part IV below.

d ☐ I converted the entire home to a rental or business use OR I still own the home but no longer use it as my main home. Go to Part IV below.

e ☐ I transferred the home to my spouse (or ex-spouse as part of my divorce settlement). The full name of my ex-spouse is ▶

____

The responsibility for repayment of the credit is transferred to your spouse or ex-spouse. Stop here.

f ☐ My home was destroyed, condemned, or disposed of under threat of condemnation and I acquired or plan to acquire a new home within 2 years of the event.

• For homes purchased in 2008, repayment of the credit over a 15-year period begins with your 2010 tax return. Check box b on line 16. If you purchase a new home within 2 years of the event, your annual payment requirement does not change.

• For homes purchased in 2009 or a later year, you may not have to repay the credit (see instructions).

g ☐ My home was destroyed, condemned, or disposed of under threat of condemnation and I do not plan to acquire a new home within 2 years of the event (see instructions).

h ☐ The taxpayer who claimed the credit died in 2010. No repayment of the credit is required of the deceased taxpayer. If you are filing a joint return for 2010 with the deceased taxpayer, see instructions. Otherwise, stop here.

Part IV **Repayment of Credit Claimed for 2008 or 2009**

14	Enter the amount of the credit you claimed on Form 5405 for 2008 or 2009. See instructions if you filed a joint return for the year you claimed the credit. If you checked box 13a above, go to line 15. Otherwise, skip line 15 and go to line 16	**14**		
15	Enter the gain on the sale of your main home (as figured after reducing your basis by the amount on line 14 above) (see instructions)	**15**		
16	Check the box below that applies to you. (Check only one box.)			
a	☐ I am reporting a disposition or change in use of my main home. If you checked box 13a above, enter the smaller of line 14 or line 15. Otherwise, enter the amount from line 14.			
b	☐ I am paying an installment of the credit I claimed for a home purchased in 2008. Divide line 14 by 15.0. This is the minimum amount you must repay with your 2010 return. Enter this amount (or a larger amount if you choose) here. (see instructions)	**16**		

Next: Include the amount from line 16 on your 2010 Form 1040, line 59, or Form 1040NR, line 58. Check the "Form 5405" box on that line.

Form **5405** (Rev. 12-2010)

EXHIBIT C.6 ***(Continued)***

Form **8863**

Department of the Treasury
Internal Revenue Service (99)

Education Credits (American Opportunity and Lifetime Learning Credits)

▶ See separate instructions to find out if you are eligible to take the credits.
▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-0074

2010

Attachment Sequence No. 50

Name(s) shown on return	Your social security number

Part I **American Opportunity Credit**

Caution: *You **cannot** take the American opportunity credit for more than **4** tax years for the **same student.***

1	**(a)** Student's name (as shown on page 1 of your tax return) First name / Last name	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses (see instructions). **Do not** enter more than $4,000 for each student.	**(d)** Subtract $2,000 from the amount in column (c). If zero or less, enter -0-.	**(e)** Multiply the amount in column (d) by 25% (.25)	**(f)** If column (d) is zero, enter the amount from column (c). Otherwise, add $2,000 to the amount in column (e).

2 **Tentative American opportunity credit.** Add the amounts on line 1, column (f). If you are taking the lifetime learning credit for a different student, go to Part II; otherwise, go to Part III . . . . ▶ 2

Part II **Lifetime Learning Credit**

Caution: *You **cannot** take the American opportunity credit and the lifetime learning credit for the **same student** in the same year.*

3	**(a)** Student's name (as shown on page 1 of your tax return) First name	Last name	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses (see instructions)

4	Add the amounts on line 3, column (c), and enter the total	4	
5	Enter the **smaller** of line 4 or $10,000	5	
6	**Tentative lifetime learning credit.** Multiply line 5 by 20% (.20). If you have an entry on line 2, go to Part III; otherwise go to Part IV	6	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 25379M Form **8863** (2010)

EXHIBIT C.7 Form 8863

Form 8863 (2010) Page 2

Part III Refundable American Opportunity Credit

7	Enter the amount from line 2			7	
8	Enter: $180,000 if married filing jointly; $90,000 if single, head of household, or qualifying widow(er)	8			
9	Enter the amount from Form 1040, line 38,* or Form 1040A, line 22	9			
10	Subtract line 9 from line 8. If zero or less, **stop**; you cannot take any education credit	10			
11	Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	11			
12	If line 10 is: • Equal to or more than line 11, enter 1.000 on line 12 • Less than line 11, divide line 10 by line 11. Enter the result as a decimal (rounded to at least three places)			12	.
13	Multiply line 7 by line 12. **Caution:** If you were under age 24 at the end of the year **and** meet the conditions on page 5 of the instructions, you **cannot** take the refundable American opportunity credit. Skip line 14, enter the amount from line 13 on line 15, and check this box ► ☐			13	
14	**Refundable American opportunity credit.** Multiply line 13 by 40% (.40). Enter the amount here and on Form 1040, line 66, or Form 1040A, line 43. Then go to line 15 below			14	

Part IV Nonrefundable Education Credits

15	Subtract line 14 from line 13			15	
16	Enter the amount from line 6, if any. If you have no entry on line 6, skip lines 17 through 22, and enter the amount from line 15 on line 8 of the Credit Limit Worksheet (see instructions)			16	
17	Enter: $120,000 if married filing jointly; $60,000 if single, head of household, or qualifying widow(er)	17			
18	Enter the amount from Form 1040, line 38,* or Form 1040A, line 22	18			
19	Subtract line 18 from line 17. If zero or less, skip lines 20 and 21, and enter zero on line 22	19			
20	Enter: $20,000 if married filing jointly; $10,000 if single, head of household, or qualifying widow(er)	20			
21	If line 19 is: • Equal to or more than line 20, enter 1.000 on line 21 and go to line 22 • Less than line 20, divide line 19 by line 20. Enter the result as a decimal (rounded to at least three places)			21	.
22	Multiply line 16 by line 21. Enter here and on line 1 of the Credit Limit Worksheet (see instructions) ►			22	
23	**Nonrefundable education credits.** Enter the amount from line 13 of the Credit Limit Worksheet (see instructions) here and on Form 1040, line 49, or Form 1040A, line 31			23	

*If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter.

Form **8863** (2010)

EXHIBIT C.7 (*Continued*)

Form **5695**

Department of the Treasury
Internal Revenue Service

Residential Energy Credits

▶ **See instructions.**
▶ **Attach to Form 1040 or Form 1040NR.**

OMB No. 1545-0074
2010
Attachment Sequence No. **158**

Name(s) shown on return | **Your social security number**

Part I **Nonbusiness Energy Property Credit** (See instructions before completing this part.)

1	Were the qualified energy efficiency improvements or residential energy property costs for your main home located in the United States? (see instructions) . . . . ▶	**1**	☐ **Yes** ☐ **No**
	Caution: *If you checked the "No" box, you cannot claim the nonbusiness energy property credit. Do not complete Part I.*		
2	Qualified energy efficiency improvements (see instructions).		
a	Insulation material or system specifically and primarily designed to reduce the heat loss or gain of your home	**2a**	
b	Exterior windows (including certain storm windows) and skylights	**2b**	
c	Exterior doors (including certain storm doors)	**2c**	
d	Metal roof with appropriate pigmented coatings or asphalt roof with appropriate cooling granules that are specifically and primarily designed to reduce the heat gain of your home, and the roof meets or exceeds the Energy Star program requirements in effect at the time of purchase or installation	**2d**	
3	Residential energy property costs (see instructions).		
a	Energy-efficient building property	**3a**	
b	Qualified natural gas, propane, or oil furnace or hot water boiler	**3b**	
c	Advanced main air circulating fan used in a natural gas, propane, or oil furnace	**3c**	
4	Add lines 2a through 3c	**4**	
5	Multiply line 4 by 30% (.30)	**5**	
6	Maximum credit amount. (If you jointly occupied the home, see instructions)	**6**	*$1,500*
7	Enter the amount, if any, from your 2009 Form 5695, line 11. Otherwise enter -0-	**7**	
8	Subtract line 7 from line 6	**8**	
9	Enter the smaller of line 5 or line 8	**9**	
10	Limitation based on tax liability. Enter the amount from the Credit Limit Worksheet (see instructions)	**10**	
11	**Nonbusiness energy property credit.** Enter the smaller of line 9 or line 10. Also include this amount on Form 1040, line 52, or Form 1040NR, line 49	**11**	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 13540P Form **5695** (2010)

EXHIBIT C.8 Form 5695

Form 5695 (2010) Page 2

Part II **Residential Energy Efficient Property Credit** (See instructions before completing this part.)

Note. *Skip lines 12 through 21 if you only have a* ***credit carryforward from 2009.***

Line	Description				
12	Qualified solar electric property costs			12	
13	Qualified solar water heating property costs			13	
14	Qualified small wind energy property costs			14	
15	Qualified geothermal heat pump property costs			15	
16	Add lines 12 through 15			16	
17	Multiply line 16 by 30% (.30)			17	
18	Qualified fuel cell property costs	18			
19	Multiply line 18 by 30% (.30)	19			
20	Kilowatt capacity of property on line 18 above ▶ ____.____ x $1,000	20			
21	Enter the smaller of line 19 or line 20			21	
22	Credit carryforward from 2009. Enter the amount, if any, from your 2009 Form 5695, line 28			22	
23	Add lines 17, 21, and 22			23	
24	Enter the amount from Form 1040, line 46, or Form 1040NR, line 44	24			
25	**1040 filers:** Enter the total, if any, of your credits from Form 1040, lines 47 through 50; line 11 of this form; line 12 of the Line 11 worksheet in Pub. 972 (see instructions); Form 8396, line 9; Form 8859, line 3; Form 8834, line 22; Form 8910, line 21; Form 8936, line 14; and Schedule R, line 22. **1040NR filers:** Enter the amount, if any, from Form 1040NR, lines 45 through 47; line 11 of this form; line 12 of the Line 11 worksheet in Pub. 972 (see instructions); Form 8396, line 9; Form 8859, line 3; Form 8834, line 22; Form 8910, line 21; and Form 8936, line 14.	25			
26	Subtract line 25 from line 24. If zero or less, enter -0- here and on line 27			26	
27	**Residential energy efficient property credit.** Enter the smaller of line 23 or line 26. Also include this amount on Form 1040, line 52, or Form 1040NR, line 49			27	
28	Credit carryforward to 2011. If line 27 is less than line 23, subtract line 27 from line 23	28			

Form **5695** (2010)

EXHIBIT C.8 ***(Continued)***

Form **4562** | **Depreciation and Amortization** **(Including Information on Listed Property)** | OMB No. 1545-0172 **2010**

Department of the Treasury Internal Revenue Service (99) | ▶ See separate instructions. ▶ Attach to your tax return. | Attachment Sequence No. 67

Name(s) shown on return	Business or activity to which this form relates	Identifying number

Part I Election To Expense Certain Property Under Section 179
Note: *If you have any listed property, complete Part V before you complete Part I.*

1	Maximum amount. See the instructions for a higher limit for certain businesses	1	$500,000*
2	Total cost of section 179 property placed in service (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	$2,000,000*
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	

6 (a) Description of property	(b) Cost (business use only)	(c) Elected cost
7 Listed property. Enter the amount from line 29	7	

8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	
10	Carryover of disallowed deduction from line 13 of your 2009 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions)	11	
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11	12	
13	Carryover of disallowed deduction to 2011. Add lines 9 and 10, less line 12 ▶	13	

Note: *Do not use Part II or Part III below for listed property. Instead, use Part V.*

Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property.**)** (See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions)	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III MACRS Depreciation (Do not include listed property.**)** (See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2010	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B—Assets Placed in Service During 2010 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C—Assets Placed in Service During 2010 Tax Year Using the Alternative Depreciation System

(a) Classification of property	(b)	(c)	(d)	(e)	(f)	(g)
20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	

Part IV Summary (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12906N Form **4562** (2010)

EXHIBIT C.9 Form 4562

***This form has been updated by the author; The IRS has not yet released an updated form.**

Form 4562 (2010) Page 2

Part V **Listed Property** (Include automobiles, certain other vehicles, cellular telephones, certain computers, and property used for entertainment, recreation, or amusement.)

Note: *For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete* **only** *24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.*

Section A—Depreciation and Other Information (Caution: *See the instructions for limits for passenger automobiles.***)**

24a Do you have evidence to support the business/investment use claimed? ☐ **Yes** ☐ **No** **24b** If "Yes," is the evidence written? ☐ **Yes** ☐ **No**

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions) .						25		
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L –		
		%				S/L –		
		%				S/L –		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1 .						28		
29 Add amounts in column (i), line 26. Enter here and on line 7, page 1							29	

Section B—Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
30 Total business/investment miles driven during the year (**do not** include commuting miles) .												
31 Total commuting miles driven during the year												
32 Total other personal (noncommuting) miles driven												
33 Total miles driven during the year. Add lines 30 through 32												
	Yes	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**	**Yes**	**No**
34 Was the vehicle available for personal use during off-duty hours?												
35 Was the vehicle used primarily by a more than 5% owner or related person? . . .												
36 Is another vehicle available for personal use?												

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who **are not** more than 5% owners or related persons (see instructions).

	Yes	**No**
37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners		
39 Do you treat all use of vehicles by employees as personal use?		
40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?		
41 Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.) . . .		
Note: *If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.*		

Part VI **Amortization**

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2010 tax year (see instructions):					
43 Amortization of costs that began before your 2010 tax year				43	
44 **Total.** Add amounts in column (f). See the instructions for where to report				44	

Form **4562** (2010)

EXHIBIT C.9 (*Continued*)

Form **8815**

Department of the Treasury
Internal Revenue Service (99)

Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989

(For Filers With Qualified Higher Education Expenses)

▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-0074

2010

Attachment Sequence No. **167**

Name(s) shown on return	**Your social security number**

1 **(a)** Name of person (you, your spouse, or your dependent) who was enrolled at or attended an eligible educational institution	**(b)** Name and address of eligible educational institution

If you need more space, attach a statement.

2	Enter the total qualified higher education expenses you paid in 2010 for the person(s) listed in column (a) of line 1. See the instructions to find out which expenses qualify	**2**	
3	Enter the total of any nontaxable educational benefits (such as nontaxable scholarship or fellowship grants) received for 2010 for the person(s) listed in column (a) of line 1 (see instructions)	**3**	
4	Subtract line 3 from line 2. If zero or less, **stop.** You **cannot** take the exclusion	**4**	
5	Enter the total proceeds (principal and interest) from all series EE and I U.S. savings bonds **issued after 1989** that you **cashed during 2010**	**5**	
6	Enter the interest included on line 5 (see instructions)	**6**	
7	If line 4 is equal to or more than line 5, enter "1.000." If line 4 is less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places)	**7**	× .
8	Multiply line 6 by line 7	**8**	
9	Enter your modified adjusted gross income (see instructions) **9**		
	Note: *If line 9 is $85,100 or more if single or head of household, or $135,100 or more if married filing jointly or qualifying widow(er),* ***stop.*** *You* ***cannot*** *take the exclusion.*		
10	Enter: $70,100 if single or head of household; $105,100 if married filing jointly or qualifying widow(er) **10**		
11	Subtract line 10 from line 9. If zero or less, skip line 12, enter -0- on line 13, and go to line 14 . . . . **11**		
12	Divide line 11 by: $15,000 if single or head of household; $30,000 if married filing jointly or qualifying widow(er). Enter the result as a decimal (rounded to at least three places)	**12**	× .
13	Multiply line 8 by line 12	**13**	
14	**Excludable savings bond interest.** Subtract line 13 from line 8. Enter the result here and on Schedule B (Form 1040A or Form 1040), line 3 . . . . ▶	**14**	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 10822S Form **8815** (2010)

EXHIBIT C.10 Form 8815

Glossary

A

Above-the-line deductions Deductions subtracted from gross income to arrive at adjusted gross income (AGI).

Adjusted basis The basis of property reduced by any allowable adjustments, such as first-year expensing and depreciation.

Adjusted gross income (AGI) Gross income less allowable adjustments, such as deductions for IRA contributions, alimony payments, and one-half of self-employment tax. AGI determines eligibility for various tax benefits (e.g., certain itemized deductions, making IRA contributions if you're a plan participant, and deducting $25,000 rental loss allowance).

Alternative minimum tax (AMT) A tax triggered if certain tax benefits reduce your regular income tax below the tax computed on Form 6251 for AMT purposes.

B

Basis Generally, the amount paid for property. You need to know your basis to figure gain or loss on a sale or, in the case of business or investment property, the depreciation that can be claimed. For the basis of property acquired by gift or inheritance, *see* Carryover basis and Stepped-up basis.

Bonus depreciation An additional 50 percent depreciation allowance for the first year business property is acquired and placed in service during a specified period.

C

Capital gain rates Special tax rates imposed on sales or exchanges resulting in long-term capital gains.

Carryback A tax technique for receiving a refund of taxes in prior years by applying a deduction or credit from a current year to a prior tax year. For example, a business net operating loss incurred in 2010 may be carried back for two years in most situations; a general business credit carryback in 2010 is five years for small businesses.

Carryforward A tax technique of applying a loss or credit from a current year to a later tax year. For example, a business net operating loss incurred in 2010 may be carried forward for 20 years; a personal charitable contribution in excess of current limits has a five-year carryforward.

Carryover basis The basis in which a taxpayer uses the basis of the person from whom he or she acquired the property (e.g., property acquired by gift or in a marital property settlement).

Cash method of accounting Reporting income when actually or constructively received and deducting expenses when paid.

Charitable organizations Tax-exempt organizations to which contributions can be made on a tax-deductible basis. Charitable organizations may *not* be treated as designated beneficiaries of IRAs or qualified retirement plan benefits.

Child For tax purposes, different definitions apply for different purposes (with different definitions covered in this book).

Child and dependent care credit A credit of up to 35 percent of certain care expenses incurred to allow you to work.

Child tax credit A credit in 2010 of up to $1,000 per eligible child (under the age of 17) if your income does not exceed certain limits.

Conservation easement A right given to a charitable organization or government body to use land for recreation, the preservation of open space, or as plant or wildlife refuges.

Constructive receipt A tax rule that taxes income that is not actually received by you but that you may draw upon.

Cost-of-living adjustment An increase in a tax item due to changes in the rate of inflation.

Coverdell education savings account (ESA) A special savings account to fund certain education expenses (formerly called an education IRA).

Credit A tax credit that reduces tax liability on a dollar-for-dollar basis.

D

Deductions Items directly reducing income. Personal deductions, such as medical expenses, are allowed only if you itemize them on Schedule A. Other deductions, such as alimony and student loan interest, are subtracted from gross income (even if other deductions aren't itemized).

Deemed depreciation A basis adjustment for vehicles used in business for which the IRS standard mileage rate is used to figure annual deductions for driving.

Deferred compensation A portion of earnings withheld by an employer (or put into a retirement plan) for distributions to the employee at a later date. If certain requirements are met, the deferred amounts are not currently taxable but are taxed when received at that later time (typically retirement).

Defined benefit plan A retirement plan that pays fixed benefits based on actuarial projections.

Defined contribution plan A retirement plan that pays benefits based on contributions to individual accounts, plus accumulated earnings. Contributions generally are based on a percentage of salary or net earnings from self-employment.

Dependency exemption A fixed deduction allowed to every taxpayer, except anyone who may be claimed as a dependent on another taxpayer's return. Extra dependency exemptions are allowed for a spouse on a joint return and for each qualifying dependent.

Dependent A person supported by another person. If certain tests are met, a dependency exemption may be claimed for the dependent.

Designated beneficiary A person (or trust) in existence on September 30 of the year following the death of an IRA owner or employee who is named in an IRA or qualified retirement plan to receive distributions.

Dividends Payments by corporations to shareholders from earnings and profits ("qualified" dividends are taxed at capital gain rates).

E

Earned income Compensation for performing personal services. You must have earned income to make an IRA contribution or claim the earned income credit.

Earned income credit A tax credit allowed to a taxpayer with earned income (or AGI) below certain thresholds.

Education credits There are two education credits for 2010: the American Opportunity credit and the lifetime learning credit. They are credits for paying certain qualified higher education costs.

Educators For purposes of the deduction for educator expenses, they are teachers, aides, counselors, and principals in grades K–12 who work at least 900 hours during the school year.

Elective deferrals A portion of an employee's salary withheld and contributed to a 401(k) or other retirement plan. These amounts are not currently taxed as salary.

Estate tax A tax imposed on the value of a decedent's taxable estate, after deductions and credits.

Estimated tax Advance payment of current tax liability based either on wage withholding or on installment payments of estimated tax liability. Payments must meet certain requirements to avoid an underpayment penalty.

Exclusion A rule allowing income to be tax free.

Exemption For AMT purposes, it is an amount subtracted from alternative minimum taxable income. For estate, gift, and generation-skipping transfer tax purposes, it is an amount that is translated into a credit to offset the applicable tax. *Also see* Dependency exemption.

F

401(k) plan A deferred pay plan authorized by Section 401(k) of the Internal Revenue Code under which a percentage of an employee's salary is withheld (called an elective deferral) and placed in a qualified retirement plan. Income on the elective deferrals accumulates on a tax-deferred basis until withdrawn by the employee (generally when he or she retires or leaves the company).

529 plan *See* Qualified tuition plan.

Façade easement A charitable contribution that preserves the exterior of a historic building.

Fair market value What a willing buyer would pay to a willing seller when neither is under any compulsion to buy or sell.

Fellowships *See* Scholarships.

First-year expensing A deduction up to a set dollar limit for the cost of business equipment placed in service in the year. This deduction is also called a Section 179 deduction.

Flexible spending arrangements (FSAs) A salary reduction plan that allows employees to pay for medical coverage or dependent care expenses on a pretax basis.

Foreign child A child who is not a U.S. citizen or resident at the time adoption efforts commence.

Foreign earned income exclusion In 2010, up to $91,500 of foreign earned income is exempt from tax if a foreign residence or physical presence test is met.

G

General business credit An overall limitation on certain business credits. Amounts in excess of the limitation can be carried back for one year (five years in 2010 for small businesses), with unused amounts carried forward for up to 20 years.

Generation-skipping transfer tax A tax on a transfer that skips a generation (e.g., from grandparent to grandchild).

Gift tax Gifts in 2010 in excess of the annual exclusion of $13,000 per donee are subject to gift tax, but the tax may be offset by a person's lifetime gift tax exemption amount.

Gross income The total amount of income received from all sources before exclusions and deductions.

H

Head of household Generally, an unmarried person who maintains a household for dependents and is allowed to compute income tax based on head of household rates (which are more favorable than single-person rates).

Health reimbursement arrangement (HRA) An employer-funded account that can be tapped tax free to pay for medical expenses.

Health savings account (HSA) A savings account that accompanies a high-deductible health plan; funds from the account can be tapped tax free to pay for certain medical costs.

High-income taxpayers Taxpayers with AGI over a set limit who are subject to certain phaseouts or reductions in benefits. They are also subject to a different estimated tax safe harbor.

Home sale exclusion A portion of gain on the sale of a main home that can be received tax free if certain conditions are met.

Hybrid cars Cars powered by both gas and electricity and that may be eligible for a tax credit.

I

Incentive stock options (ISOs) Options meeting tax law tests that defer regular income tax on the option transaction until the obtained stock is sold (but the exercise of ISOs may give rise to AMT).

Inclusion amount In the case of cars leased for business, an amount that must be added back to income for cars that initially have a fair market value over a set dollar amount.

Income shifting A tax technique designed to shift income among family members from one who is in a higher tax bracket to another in a lower tax bracket.

Indexing *See* Cost-of-living adjustment.

Individual retirement account (IRA) A retirement account to which a limited contribution is permitted annually from earned income (or alimony), but deductions are restricted for active participants in qualified retirement plans who earn over set amounts.

Installment sale A sale of property that allows for tax deferment if at least one payment is received after the year in which the sale occurs. The installment method does not apply to year-end sales of publicly traded securities. Dealers may not use the installment method. Investors with very large installment balances could face a special tax.

Irrevocable trusts Trusts that cannot be changed by the creator once they come into existence.

Itemized deductions Items, such as medical expenses, home mortgage interest, and state and local taxes, that are claimed as write-offs on Schedule A

of Form 1040 in lieu of claiming the standard deduction. Itemized deductions are subtracted from AGI to arrive at taxable income. The amount of itemized deductions is subject to a reduction when AGI exceeds certain limits.

J

Joint return A return filed by a married couple reporting their combined income and deductions. Joint return status generally provides tax savings over filing separate returns for married couples.

K

Kiddie tax The tax on investment income in excess of $1,900 in 2010 of a child under a certain age, based on the parents' top marginal tax rate and computed on Form 8615.

L

Long-term capital gain or loss Gain or loss on the sale or exchange of a capital asset held more than one year.

Luxury cars Cars costing more than a certain amount that are subject to dollar limits on depreciation, trigger inclusion amounts if leased, and result in excise taxes.

M

Marital deduction An estate and gift tax deduction for assets passing to a spouse. In the case of a spouse who is a U.S. citizen, completely tax-free transfers are allowed.

Marriage penalty The additional tax paid by a married couple that would not be owed if they had remained single.

Miscellaneous itemized deductions Generally, itemized deductions for job and investment expenses subject to a limit of 2 percent of AGI.

Modified adjusted gross income (MAGI) This is generally adjusted gross income increased by certain items (e.g., tax-free foreign earned income). MAGI is used to determine the phaseouts for certain deductions and credits.

Modified carryover basis The basis that applies to property inherited from a person dying in 2010; it combines stepped-up basis and carryover basis rules. *See* Carryover basis and Stepped-up basis.

Moving expenses Certain expenses of moving to a new job location are deductible if distance and time tests are met.

N

Nanny tax Employment taxes on household employees.

Net operating loss (NOL) A business loss that exceeds current income may be carried back against income of prior years and carried forward as a deduction from future income until eliminated.

O

Ordinary income Income other than capital gains.

Ordinary loss A loss other than a capital loss.

P

Personal exemption A deduction of $3,650 in 2010 that every taxpayer (other than someone who can be claimed as a dependent of another taxpayer) may claim for him/herself.

Placed in service The time when a depreciable asset is ready to be used in business. The date fixes the beginning of the depreciation period or eligibility for first-year expensing.

Probate estate Property held in a decedent's name passing by will (or under the terms of state laws of intestacy).

Profit-sharing plan A defined contribution plan under which the amount contributed to employees' accounts is based on a percentage of the employer's profits.

Q

Qualified plan A retirement plan that meets tax law tests and allows tax deferment and tax-free accumulation of income until benefits are withdrawn. Pension plans, profit-sharing plans, SEPs, and SIMPLEs are qualified plans.

Qualified tuition plan A higher education savings plan sponsored by a state or private institution.

Qualifying widow or widower A filing status entitling a taxpayer with a dependent to use joint tax rates (and the standard deduction for joint filers) for up to two years after the death of a spouse.

R

Refundable tax credit A credit that entitles you to receive a refund even if the amount exceeds your tax for the year.

Required minimum distributions (RMDs) Annual withdrawals that must be made from IRAs and qualified plans to avoid a 50 percent penalty.

Retirement savings contributions credit A credit for elective deferrals or IRA contributions that may be claimed by a person with income below a set limit (in addition to any other tax benefit related to the elective deferrals or IRA contributions).

Revocable trust A trust that may be changed or terminated by its creator (e.g., a "living trust"). Such trusts generally do not provide any income tax savings to the creator.

Rollover A tax-free reinvestment of a distribution from a qualified retirement plan or IRA into another plan or IRA within 60 days.

Roth IRA A nondeductible IRA that allows for tax-free accumulations of earnings.

S

Salary reduction agreement Consent to have an employer withhold a portion of wages that will be contributed to a qualified retirement plan or flexible spending arrangement. Such amounts are not currently taxed as wages.

Savings incentive match plan for employees (SIMPLE) A type of retirement plan funded by elective deferrals and employer matching contributions.

Scholarships Grants to degree candidates receiving tax-free treatment if used for tuition and course-related expenses.

Section 179 deduction *See* First-year expensing.

Section 457 plan A deferred compensation plan set up by a state or local government or tax-exempt organization that allows tax-free deferrals of salary.

Self-employed person An individual who operates a business or profession as a proprietor or independent contractor and reports self-employment income on Schedule C.

Self-employment tax Social Security and Medicare taxes paid by a self-employed person. The Social Security portion is 12.4 percent on net earnings from self-employment up to $106,800 in 2010. The Medicare portion is 2.9 percent

on all net earnings from self-employment. One-half of the total self-employment tax is deductible.

Separate returns Returns filed by married persons who do not file a joint return. Filing separately may save taxes where each spouse has separate deductions, but certain tax benefits require joint filing.

Short-term capital gain or loss Gain or loss on the sale or exchange of a capital asset held one year or less.

Simplified employee pension plan (SEP) An IRA-type plan set up by an employer or self-employed person rather than an employee.

Single The filing status of a person who is unmarried on December 31 of the year for which a return is filed.

Special needs child For purposes of a Coverdell ESA, this is a child who needs more time to complete his or her education because of a physical, mental, or emotional condition. For purposes of the adoption credit, it is a child under age 18 who is physically or mentally incapable of self-care.

Standard deduction A fixed deduction allowed to those who do not itemize deductions. The amount depends on filing status, age, and whether a person is blind.

Standard mileage rate A fixed rate set by the IRS for deducting auto expenses in lieu of deducting actual costs.

Stepped-up basis The basis of property for inheritances; it fixes the basis for determining an heir's gain or loss by the value of the property for estate tax purposes.

T

Taxable income Net income after claiming all deductions (including personal exemptions).

Tax brackets In 2010, there are six individual federal income tax brackets—10 percent, 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent.

Tax-free exchange A trade of property that defers the recognition of gain until the property received in the transaction is later disposed of (but only if qualified property is involved).

Tax preference items Items that may subject a taxpayer to the alternative minimum tax (AMT).

Trust An arrangement under which one person transfers legal ownership of assets to another person or corporation (the trustee) for the benefit of one or more parties (beneficiaries).

U

Unearned income Investment income or other income that is *not* derived from performing personal services.

V

Vesting The process of accruing an interest in contributions that are treated as earned. Employee contributions are always 100 percent vested. Employer contributions may be immediately vested or vested over a set schedule.

W

Withholding An amount taken from income as a prepayment of tax liability for the year. In the case of wages, the employer withholds part of every wage payment for this purpose.

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