



TAX SAVING STRATEGIES NEWSLETTER

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2010 Tax Outlook

President Obama took office pledging to raise taxes for individuals earning more than \$200,000 and families earning more than \$250,000. He also pledged to impose additional payroll tax of 2% to 4% for earned income above those amounts.

Since taking office, the new administration has offered a variety of cuts for lower- and middle-income Americans. These include new credits for working individuals, expanded breaks for higher education, extended breaks for homebuyers, and even a temporary sales-tax deduction for new car purchases. While these changes have made taxes more complicated, they've done nothing to stall future tax hikes.

The recent healthcare reform act actually makes it harder to deduct healthcare costs, and imposes significant new taxes on investment income. With the federal budget deficit approaching \$2 trillion per year, many observers see the new healthcare taxes as the tip of a looming iceberg.

This report summarizes some of the future tax hikes we can expect and offers suggestions for avoiding them.

Tax Brackets Going Up

Tax on ordinary income is currently capped at 33% and 35% for taxpayers in the highest brackets. On January 1, 2011, those rates rise automatically to 36% and 39.6% unless Congress votes to keep the Bush administration tax cuts.

If you expect your 2011 income to be significantly more or less than in 2010 (as may be the case if you retire, buy or sell a business, or sell significant investments), consider timing income and deductions for maximum tax advantage.

If you expect your income to go DOWN in 2011, consider delaying income (to subject it to tax at next year's lower tax brackets) and paying deductible expenses this year, to the extent possible.

If you expect your income to go UP in 2011, consider accelerating income from commissions, bonuses, and qualified plan withdrawals (to subject it to tax at this year's lower rate), and delaying deductible expenses until next year.

Itemized Deductions Going Down

President Obama has proposed limiting the value of itemized deductions to just 28%, even for taxpayers in higher brackets. This would amount to a "stealth" tax increase and cut the value of deductions for medical expenses, state and local taxes, mortgage interest, and even charitable gifts. The administration proposes to make this change effective January 1, 2011.

Tax Strategies for Healthcare Costs

Paying for medical care becomes harder every year. The recent healthcare reform act improves coverage and extends it to more Americans, but actually makes it harder to deduct unreimbursed expenses. (Under current law, you can deduct medical expenses exceeding 7.5% of your Adjusted Gross Income. Under the new law, starting in 2013, that floor rises to 10%.) It also limits contributions to employer-sponsored flexible spending plans to \$2,500/year.

If you're free to select your own coverage, consider choosing a "high-deductible health plan" and opening a Health Savings Account. These arrangements bring down premium costs and use pre-tax dollars for out-of-pocket costs, bypassing the floor on AGI.

If you're self-employed, consider establishing a Medical Expense Reimbursement Plan, or MERP. These plans let you pay family medical expenses with pre-tax business dollars. They may even help you avoid self-employment tax.

Audit Odds Still Low

IRS audit odds are increasing, from 1 in 200 returns for 2000 to 1 in 100 for 2008. But your chance of getting audited is still minimal. Don't take low audit rates as an invitation to cheat! But don't let fear of an audit stop you from taking every legitimate deduction you're entitled to deduct.

Some Changes Made By The Affordable Health Choices Act Passed on March 23, 2010

For small businesses, a new tax credit on a sliding scale for up to 50% of the total premium cost of providing health care coverage to their workers. Small businesses eligible for the credit must have fewer than 25 employees and average annual wages of less than \$50,000 for 2010 through 2013. Employers with 10 or fewer employees and average annual wages of less than \$25,000 are eligible for the full credit.

Beginning in 2014, most individuals must have insurance coverage or face a penalty of up to \$695 or 2½% of income. Of course this will be paid on the income tax return.

Beginning in 2013 the Medicare tax will increase by 3.8% on earned income above \$200,000, for individuals, or above \$250,000 for joint returns.

Beginning in 2013 there will be a Medicare tax of 3.8% on investment income for filers with adjusted gross income above \$200,000 for individuals or above \$250,000 for joint returns. Investment income includes interest, dividends, annuities, royalties and rents. However this does not include distributions from retirement plans.

Beginning in 2012 the requirement for reporting payments of \$600 or more will be extended to corporations. In addition, the reporting requirement will apply to payments for property and other gross proceeds.