TAX NEWS & TIPS

FALL 2013

No New Laws – Yet!

As I write this, Congress is busy making noises about "reforming" our tax system. But, so far it's only talk. If we do see any major new laws, I'll do my best to keep you informed. For the moment I'm busy keeping abreast of the laws we already have on the books!

In This Issue

Tax Tune-Up

2013 is more than half gone. This is a good time to ask yourself, "How am I doing?"

Are you safe to presume things will be similar to 2012? Or, has your income or withholding changed in a significant way?

☑ **Law Changes?** Of course there are changes. Frankly, most new rules affect those with higher incomes, say, above $200,000. I tried to warn most of those folks during my "tax season", but if you're worried, please give me a call. Most of you need to worry about your income, not the laws!

☑ **Check Income First.** Any significant change in income can have a big impact on your tax bill. Our "graduated" tax rates can fool you. Sometimes a 10% income jump can cause a 20% increase in your tax bill. If there is income I wasn't told to expect, give me a call. I'd like to give you an early warning.

☑ **Unscheduled Income?** Look for unemployment benefits, starting to collect social security or pension income, the sale of an investment property or rental.

☑ **Life-Situation Changes.** Did you marry or divorce? Is there a new child? Changing how you "look" to the government can cause a big tax surprise. Look at job changes, sale of your home, a move, starting or stopping work, a new business. Alert me to any such changes.

☑ **Withholding & Estimates.** Most of us depend on withholding to cover our taxes. Let's be sure yours is up to speed. If withholding is not enough, you might need to make estimated tax payments. I can help.

☑ **When You Call Me.** I work for a living, too. My fee is related to the work I do for you. Please don't be afraid to call. If *both of us* have realistic estimates of your position, we'll *save* time overall. I'd like to think we *each* reach December with a good idea of where you stand. If either of us is surprised by the final results, *one of us* dropped the ball!

Top Tax Savers

Congress is talking about taxes again. Clearly we have a budget problem. Will we see spending cuts or revenue raisers?

Most people think we'll see some of both. When Congress reviews tax laws, the Treasury Department gives them a list of the biggest tax savers (revenue losers). It's tempting to start where the biggest reward lies.

Here are the biggest tax savers in the Treasury's most recent estimates:

1. Employer-Paid Health Care is not taxed as income to you. This will cost $164 Billion in 2014! Hmmm! Maybe we should tax this!

2. Retirement Plans let you save now and pay the tax later. This will lose $162 Billion of revenue.

3. Mortgage Interest Deduction will save us $99.8 Billion in 2014!

4. Medicare Benefits cost more than retirees' premiums. Another $76 Billion spent by government.

And so on.

5. Low Rates On Capital Gains.

6. Earned Income Credit. This gives direct refunds to lower-income families with children.

7. Deducting State Taxes.

These last 3 will cost another $184 Billion. That's nearly $800 Billion so far!

Be honest now. If you were in the Congress, where would you be tempted to makes changes? If you simply subscribe to the "most bang for the buck" theory, these areas are very tempting targets.

The list goes on: non-taxable inheritances, tax credit for small children, deducting your charitable contributions, cafeteria plans, tax-exempt bonds, the part of social security that's not taxed. Another $264 Billion here.

Would Congress attack any of these? I can't say. Removing any of these would not be easy to sell to Americans. All I'm saying is – whenever Congress sits to discuss revenue, the most recent version of this list pops up.

Same-Sex Marriages & Income Taxes

On June 26, the Supreme Court made a decision we'll argue about for years to come. They struck down Section 3 of the Defense of Marriage Act (DOMA). It defined the term "marriage" as "a legal union between one man and one woman as husband and wife".

Allow me to sidestep the many thorny issues and focus solely on tax problems arising from this.

In fact, allow me to take an even more narrow focus. We have several *kinds* of taxes. If you are considered "married" you have some definite benefits in the arena of *estate* taxes. I'll focus on *income* taxes alone.

Re-File Tax Returns? In theory, the Court told IRS to accept joint returns from couples in the 13 states where such marriages are legal.

We're waiting to hear how IRS wants to handle this. New forms? Special procedures for older returns? How far back into the past? Worse, will they be *forced* to amend old returns if taxes would be higher? By October or so, we can expect some answers on procedures IRS wants us to use.

Hello "Marriage Penalty". If nothing more than filing a joint return were at stake, the IRS just scored a victory! Believe it or not, most of today's couples actually pay more tax on their "married filing jointly" tax return than if they were allowed to file as "single". We call this the "marriage penalty".

How It All Began. Congress didn't intend to take benefits away from couples. In fact, the opposite was true at the beginning. Filing a "joint" tax return was a new idea in the 1930s. Most couples saw an instant tax reduction. Why? Think about the American Family of the time. In most cases, there was a single "bread-winner", the husband. The "homemaker", the wife, was home taking care of the kids. Few women worked, and most of those stopped working upon marriage. When some of the wage earner's income was attributed to the wife, taxes went down for most couples.

Only a few couples saw their tax go up. As long as one spouse had about triple the income of the other, taxes went down. In the 1930s, most couples fit this picture. Today, we have a very different picture. Many families have two earners. And they pay a price in taxes!

1 + 1 = Less Than Two. Our current tax laws contain a couple of dozen "marriage penalty" issues. Here's one: If you own a rental that shows losses, you can write off up to $25,000 of the loss, as long as your income isn't more than $100,000. Two single people with such rentals who get married now have the same limits, not the doubled numbers you might expect. Each of them just lost 50% of the benefit by saying "I Do".

Another: When you begin to collect social security, part of your benefit can be taxed. It depends on income. Add ½ the social security to your other income. If the total is over $25,000, some of your social security is taxed. That's the rule for a single retiree. If you're married, you might expect this to start at $50,000. Nope! A couple begins to pay tax on social security at $32,000. Hmmm.

Today, about 70% of couples pay more tax than if they were two single persons. Getting married is rarely a good way to save on income taxes!

States' Rights Issues. Will the other 37 states be told to allow such marriages? Not likely. We have several areas of the law where states have the right to determine their own course. We see different rules in different states on age of adulthood, speed limits, who has the first right to inherit the property of someone who dies without a will. States are not forced to adopt one another's laws.

New problem! Suppose our same-sex couple moves to another state to retire, or for a new job. If the new state does not honor their marriage, may they file jointly? Most states begin by asking for your income as shown on the Federal return. Hmm! What about fringe benefits? Will the working spouse be allowed to include the other spouse under employer's health insurance plan? We'll be seeing these cases before long.

Serious problems. Remember the last really big argument between States and the Federal Government? We call it The Civil War!

You think such problems belong to ancient history? Several states used to charge income tax on state pensions even if the pensioner went to another state to retire. Why not? The pension was "earned" here, so we have the right to tax it! Believe it or not, this was common until just

1996, when a Federal Law ended the practice! Even more recently, in 2009, the Federal Government barred states from taxing the income of spouses of those who serve in the military, if the spouse joined the military person while stationed away from their home state.

What's Coming? I don't know yet! We'll have to wait and see. And - - - income tax is one of the *smaller* issues!

Where Do Your Tax Dollars Go?

The White House commissioned a special web site back in 2011. It helps you understand how your tax dollars are spent. It was a hit in 2011, and has been updated to reflect the Federal Budget for 2012. You can find it at www.whitehouse.gov/taxreceipt. To use the calculator, you simply find your 2012 tax return and enter what you paid in 2012 taxes. You'll get a "receipt" showing how much went to various items.

The calculator reveals important information about our nation's budget. It says 24.6% of all income tax payments we make goes to national defense, 22.5% to health care, and 17.3% to job and family security. These "top three" account for 64.4% of America's total budget.

Far smaller amounts go to other purposes. Veteran's Benefits got 4.5% of the budget, education and job training consumed 3.3%. Foreign aid and other international programs consume only 1.7% of our tax payments. National disaster response was allotted only 0.4%.

Several other areas are listed. Last, but not least, I noticed the figure for immigration and law enforcement (this is where IRS draws its enforcement budget!) consumed only 2% of our taxes.

Back To School? Maybe Big Tax Savings

Several tax laws help on costs of education. The biggest benefits go to college courses. Lots of rules, but if you have records of all expenses, I'll help you save as much as possible.

Pre-College – Coverdell ESA. Help with costs of primary and secondary school can go to folks who have Coverdell Education Savings Accounts (ESA). Money in these accounts grows tax-free. When you take money, you'll get Form 1099-Q. It shows the total withdrawal, and the un-taxed growth. If records show you paid education costs equal to the full withdrawal, all is well. If not, the growth is now taxed, and a stiff 10% penalty applies.

Undergraduate College. There are 3 different tax laws that can help. The most beneficial can give you a dollar-for-dollar rebate on the first $2,000 spent, plus 25% of the next $2,000! I'll need information on the student, and two groups of expenses.

Student. Who took the classes? You? Your spouse? One of your children? Any of you might qualify. Usually the parent gets the benefit of a child's expenses, but I'll need full details on the youngster's income to be sure who gets the benefits. Warn the youngster not to file a tax return until we know who gets the savings. Special rules apply for children of separated parents. If I know the facts before anyone files a return, I'll help you get the maximum benefit.

Tuition & Fees. Schools report fees paid on Form 1098-T. NOTE: the form is sent to the *student*, even though the tax savings normally go to the parent. Tell the student to watch for the form. It shows tuition and fees. Parking costs, insurance, and fees not related to actual coursework don't count. We must reduce these by any grants or scholarships.

Other Costs. There might be tax breaks for course supplies. Books, binders, even pencils and note pads. Track them. Some courses demand a computer – it may qualify. Look for software needed to submit required papers. Maybe we can even claim some of the on-line fees. Art and/or science classes can require many additional supplies. Track them!

Student Loans. Were the fees paid with a student loan in either your name or in the student's name? Even though you took a student loan, the fees were still paid! You are fully entitled to the tax benefits. Be sure to keep the records!

Tax Benefits & Dependency. Tax law is a little strange here – the tax savings may only be taken on the return where the personal exemption (dependency) is claimed. It doesn't matter where the money comes from. Grandma's trust, student loans, or the absent former spouse might pay the bills, but the tax benefit is claimed on the tax return where the exemption is taken. With separated parents, if they communicate well, they can even decide to waive the exemption back and forth. This can be a valuable tax strategy where one spouse has too much income to get the credit. I can help them weigh the value.

Graduate Courses. A couple of benefits can apply, but the savings are not as large as for undergraduate expenses. Only tuition & fees count. Income limits can cut the savings. But, if you have the information, I'll help you get the maximum benefit.

Job-Related Courses. Courses to "maintain or improve job skills" open another possibility. If you itemize your deductions, we may be able to claim *all* the costs for your classes. We can even claim an allowance for the mileage to go to and from classes.

Individual classes, even at "trade schools" can be claimed. Courses to qualify for a new occupation won't count here. Degree programs are tricky. IRS tends to think any new degree automatically opens the door to new occupations.

Keep The Records! Education benefits can be very valuable. Please keep records carefully. If the courses are taken by your child, you are most likely the one to benefit. Encourage the student to keep records of costs beyond the fees paid to the college.

Record-keeping takes only a couple of minutes each week. Start a file – even a sheet of paper will do. Be sure to track all costs.

As I've said, the actual rules are too complex to discuss here. If I know the details of the student, the courses, and the costs, I can compare the alternatives and secure the biggest possible savings for you.

Happy 100th Birthday To Form 1040!

Our system of personal income tax is 100 years old this year. Form 1040 and the personal income tax made its debut in 1913. The specific law creating the income tax was ratified on October 3, 1913. The law had been passed in 1909, but nearly four years of stormy debate was required before the law was finally ratified.

The original Form 1040 was three pages, plus just a single page of instructions. That's it – the entire package was four pages long. Boy, have we come a long way since then! Today's Form 1040 has several possible additional forms and over one hundred pages of complex instructions.

Only folks with a net income exceeding $3,000 were required to file. This sounds similar to our current rules, until you do a little math. A net income of $3,000 in 1913 compares to nearly $1Million today! Fewer than 35% of Americans were required to file that first tax form.

Why is the form number 1040? That's easy. The Treasury Department already had 1,039 different forms for various purposes. Clearly the next new form should draw the next number. So - - - Form 1040 it is!

Today's tax rates can reach as high as 39.6%, along with additional tax for higher income folks and special rates for capital gains and certain other income. The earliest tax return had a tax rate of 1% for most people, after claiming their "General Deductions". In addition, there was a graduated surtax, called the "Super Tax". Rates were as high as 6% for those with net income over $500,000.

That first tax return had a due date of March 1. Today we all know the familiar April 15 deadline for returns. The penalty "for failure to have this return in the hands of the Collector of Internal Revenue" ranged from $20 to $1,000. Today the penalty can reach 25% of the total tax you owe, and interest is added on top of this.

Tips For You

Starting Social Security. If you are considering receiving your social security benefit, you have lots of questions. Frankly, this goes well beyond my specialty of income tax, but I can point out a few key facts. For serious help, visit a local social security office. They can answer your questions in light of your personal earnings history.

62-66-70. These are the "key" ages. "Early" benefits can begin at any month after age 62. "Normal" benefit starts at age 66. "Delayed" benefits can start as late as age 70.

"Early" Benefit. You can start receiving payments at age 62. There are two problems. (1) your benefit is reduced by 25% of whatever amount the formulas give for your earnings history. Start at an age between 62 and 66, and the reduction is prorated over the 48 months. This will be your benefit for life. (2) If you do continue working and earn too much in any year, your give some back. This earnings limit stops at age 66.

"Normal" Benefit. At age 66, you receive the "normal" amount, with yearly inflation adjustments. No earnings limits apply. In fact, earnings will now *increase* your benefit slightly.

"Delayed" Benefit. For every month you delay after age 66, your benefit increases, but not after age 70. The annual figure is about 8%. No earnings limits apply.

What To Do? Your choice. What you're doing is wagering on your life expectancy. Your choice will "lock in" a benefit pattern – whether you live another 30 days or another 30 years!

Summertime Day Care. Special tax credits help out working parents. This summer you may have sent your child to a "day camp". These can qualify for the credits. Warning: the activity must be seen as *day care*, not as *education*. Fun and games are fine. Same for activities aimed at enriching the child's background. Museum, art projects, and wildlife programs are examples. But some computer camps or math skills tune-ups can be seen as little more than summer school. No tax benefit.

Provider I.D. To claim your tax credits we need to give complete name, address, and (in many states) telephone numbers for the provider. I'll also need the "Tax I.D. Number". Ask before you lose all contact with the sponsoring group.

Overnight Camps cannot be claimed. No overnight stays.

Over 70½? IRA To Charity. 2013 is the last year for a special tax break. Folks over 70½ must take money each year from their IRAs. Consider having the IRA *custodian* send your contribution directly to the charity. On your tax return we can deduct the contribution from your income, with no need to claim an itemized deduction. This reduces your income, and usually saves more in tax than claiming a deduction.

The custodian will charge a small fee for this service, so use this technique only for larger gifts.

Extensions Expire October 15. A few of you still have not filed for 2012. Please make an effort to find the missing information. We have little time left. In most years I am not quite as busy this time of year. 2013 is very different! I expect more planning work with clients affected by new laws. Most important, I want to give my full attention to your return, and to keep your tax bill to the absolute minimum.

An income tax form is like a laundry list – either way you lose your shirt.

Fred Allen

Your Tax Calendar

Sept. 16	3rd quarter estimated tax payments due.
Oct 15	Extensions to file 2012 Form 1040 expire.
	Forms 5500 due for pension or Keogh plans.
Nov. 1	3rd qtr. payroll returns due. (Nov. 10 if tax paid in full and on time.).
Dec 31	Last chance for deductions in 2013.
Jan 15	4th quarter estimated tax payments due for 2013.