LINDA'S ACCOUNTING SERVICE, INC.

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www.lindasaccounting.com

(651) 774-2107
4730 White Bear Parkway, Suite 101
White Bear Lake, Minnesota 55110

TAX NEWS & TIPS

MID-YEAR 2012

Thank You!

My "tax season" is always tough. But, your support made it easier.

You're The Best! Thank you for having your records in order. Thank you for your patience at my busiest time. Especially, thank you for your trust and confidence. I'll be working to keep earning this from you.

What Now?

Your return's been filed. Don't relax yet. IRS never rests. Neither does Congress. Be ready for what may happen before next year.

☑ **On Extension?** October 15 is the return deadline, but April 17 was the deadline for payments. If you do owe any tax IRS adds some carrying charges to the bill. Gather missing information quickly. We can't relax until you're safely filed. Any last-minute surprise could be expensive!

☑ **Refund Late?** IRS was slow this year. They can track e-filed returns in hours, but paper returns take 4-6 weeks after you file. Try:
1-800-829-4477 – automated help
1-800-829-1954 – refund hotline
The IRS website www.irs.gov has a "Where's My Refund?" link.

☑ **Still Owe?** IRS sent bills in May. A second round hits the mail in June. They show your balance, plus any interest and/or penalty. The bills allow a 10-day "grace period" before the amount changes again. Write your Social Security Number on the check and " 2011 Income Tax". If you can pay off the bill within a couple of months, do it.

Installment Plans. IRS allows installment plans, but there's a fee of up to $105 to set one up. I can help. But, if you can pay the balance with the second or third billing from IRS, don't waste money by asking for an installment plan.

Pay By Credit Card. You can pay this way, but a "convenience fee" of up to 3.5% applies. The fee is now deductible, but there's still a cost. Call 1-888-PAY1040. Or, go to *www.irs.gov*. Several options are listed: Under the "Hot Topics" tab, click on "Pay Your Tax Bill".

☑ **Whoops! I Forgot - - -** If you forgot some key information, we can file an amended return. Both you and IRS have 3 years after the filing deadline to change your return. If you owe money to IRS, you pay tax plus interest. If they owe you money, you collect the refund plus some interest.

☑ **Keep Your Records**. For now, put your return and all records in a safe place. You might need to dig them out for an audit some day.

Older Records. It's a good idea to keep tax returns indefinitely. Also, keep records of investments and properties you still own.

For other records – cancelled checks, receipts, bank statements, etc., I recommend you keep five years' worth of these for safety. Destroy or shred older records to protect your personal financial information. DO NOT simply toss them in the trash!

☑ **Uh-Oh – An IRS Letter!** If you get a letter from IRS, call me. The letters are confusing. Don't risk making an even bigger mess – I'll be glad to handle it.

☑ **Will You Be Audited?** There's no sure way to know. Most "audits" are really done by computer. IRS compares W-2s and 1099 forms from banks and brokers with what's on your return. When they spot enough discrepancy, you get a letter showing how much you owe if IRS is right – it looks like a bill. Don't pay! Send it to me, and we'll see what's what. IRS is not always right.

Last year IRS "audited" 1.11% of returns, or one of every 90 returns they received. Most were simple "matching" issues. Only 15% of audits involved a face-to-face meeting with an IRS auditor. That's about one of every 600 returns. Even in a face-to-face audit IRS doesn't act unless their changes cause you at least $200 in taxes.

Call me right away if you get a letter requesting a meeting!

☑ **Keep Me Posted!** We won't be doing your 2012 return for several months, but stay alert for changes that can cause a tax surprise. Let me know about family or job changes, property purchases or sales, or any new income items. We both know taxes are inevitable. Frankly, I hope you owe a lot of tax – it's a great problem to have! I hope we both have a realistic idea of how your tax bill will look. When we prepare your 2012 returns, if either of us is surprised at the result, it means *one* of us wasn't doing our job!

This Issue

Election Year Woes: Tax Laws Expiring

Congress makes the laws. IRS only enforces them. In the past 25 years Congress passed many laws in response to economic pressures. The problem: dozens of current laws that affect large numbers of us contain expiration dates. Will Congress extend them? Wait and see.

Election Year Realities. Don't expect quick help from Congress. No congressman can afford taking a stance that may cost votes. Elections are in November. Then we'll have a "lame duck" Congress until January when newly-elected members are seated. That's 2013! We may need to wait until then for answers.

Set To Expire. 2012 marks the end of the "Bush Tax Cuts" from 2001. Congress favors extending them, but is unlikely to act until next year. Some of the biggest items:

Tax Rates. These affect each and every one of us!

- Currently 10%, 15%, 25%, 28%, 33%, 35%.
- Set to be 15%, 28%, 31%, 36%, 39.6%.

Capital Gains. Long-term gains are especially favored. Folks in 10% or 15% brackets pay zero. Those in higher brackets pay only 15%. This "0% or 15%" is set to become "10% or 20%".

Qualified Dividends are ones paid by US corporations. These are taxed at the same rates as long-term capital gains – possibly at 0%. After 2012 dividends are just regular income, and taxed at normal rates.

Reduced Marriage Penalty. At present, couples move from the 15% bracket to the 25% bracket at twice the figure for singles. Their Standard Deduction amounts are also twice the figure for singles. This 200% is set to become only 167%.

Higher Income folks will lose some of the value of dependents and deductions. Their "phase-out" rules return in 2013.

Expanded Tax Credits. Also on the chopping block are a group of tax credits. Remember – tax credits are direct reductions of your tax bill. Deductions only reduce your income before calculating your tax. Credits set to be reduced for 2013:

- Child Tax Credits. Each child under 17 reduces your taxes by $1,000. In 2013 the $1,000 will be cut to $500.
- Dependent Care Credits help you with costs of day care. Set to be reduced.
- Earned Income Credits help low-income families with children. Set to go down.
- Adoption credits would decline.

Education Incentives. Many of these are set to be reduced. The valuable American Opportunity Credit, worth up to $2,500, is set to be replaced with the less valuable HOPE Credit. Expect less benefit for Coverdell Education Savings Accounts (ESAs). Also, for student loan interest, employer assistance with education, tuition deductions, and more.

Estate Tax now applies only for an estate exceeding $5 Million. Top rate is 35%. These are set to become $1 Million (indexed) and 55%.

Payroll Tax Cut. Workers paying into Social Security pay two taxes – 4.2% for basic retirement coverage, and a 1.45% Medicare portion. The 4.2% is set to return to 6.2% in 2013. For a worker earning $50,000, next year's take-home pay will drop $20 per week.

Business Provisions will see a number of cuts, from high-speed depreciation to hiring credits to research credits.

Estimated Tax. If you send out estimated tax payments, we may need to re-think your position if any of these apply to you. Also check the items in the box below.

Please call me if one of these affects you and we didn't plan for it.

Helpful Laws Expired – Will They Return?

A Batch Of Helpful Rules expired back in December. Congress has talked of extending several. Once again, we have the election year problem. It could easily be that some extenders will pass next January and be retroactive. Some of the best known:

Education & Educators. The "Tuition & Fees Deduction" of up to $4,000 for post-secondary tuitions (including vocational schools) expired. Educators could deduct up to $250 of classroom supplies - also gone.

Age Over 70½. These folks could make charitable contributions directly from IRA accounts and get the deduction without a need to itemize deductions. Plus, it was considered as part of their required distribution even though not taxed. This expired in December.

State Income Tax Or Sales Tax. You deduct state income taxes withheld or paid. For a few years we've been able to deduct the *higher* of sales tax or income tax. Folks in states with no income tax loved this one.

Mortgage Insurance Premiums were treated as interest, and could be deducted. Ended on December 31.

Alternative Minimum Tax (AMT) was enacted in 1983 to keep the "wealthy" from taking undue advantage of tax laws. It raises taxes by eating up valuable deductions and credits. Unfortunately, the measure of "wealthy" in 1983 looks "normal" today, and it's not indexed for inflation. Since 2001 we've had annual "patches" to keep the tax at bay. Under the 2011 patch AMT rules kicked in for couples when income passed $74,450. Unless Congress acts, this threshold is now back at the 1983 measure of "wealthy" – $45,000.

Several Other Provisions died on December 31. We might or might not see a revival of:

- Research Credits and hiring credits for small businesses.
- Expanded expensing provisions.
- Bonus Depreciation – 100% of costs in first year. In 2013 the items are depreciated over several years.
- Shorter depreciation life for leasehold improvements and certain restaurant & retail spaces expired.

Roth Conversion – Right For You?

The "Roth IRA" was originally to be called "American Dream Savings Account". Perfect name! Who has not dreamt "If only I could have one bank account that IRS doesn't know about!" Mr. Roth's name was added to the law at the last moment.

Traditional IRA vs. Roth IRA. Most traditional IRA contributions are deductible. You save tax now, but everything's taxed later. Roth contributions are never deductible, but all *growth* can be tax free. IRA – save now, or Roth – save later.

One little catch. For your Roth IRA to be fully non-taxable there's a test. You must reach the *later of* (1) age 59½, or (2) 5 full tax years after first opening a Roth IRA.

Wealthy Barred From Roth. If your income is too high, you can't even *make* Roth contributions. For 2012, your ability to contribute to a Roth IRA phases out for single filers as income ranges from $110,000 to $125,000. It's $173,000 to $183,000 for couples.

"Conversion" To Roth. You can take money from other retirement accounts and "convert" it to a Roth account. The Traditional IRA to Roth IRA is the most common. Two problems: (1) You must pay tax on the converted funds, and (2) there's no penalty even if you're under 59½, *but* you can't touch the money for at least 5 years, or the penalty will apply retroactively.

I Can Help. If you're thinking about such a conversion, I can help you figure out how much tax you will be forced to pay. We must also know whether you have already paid tax on some of your IRA money.

This works best if we know how your return will look, so later in the year is the best time. We might find you face lower tax brackets by only converting a limited amount this year. With one client we found she would stay in the 15% bracket by converting only $15,000 this year. You may choose to convert *any* amount at all. As you cross into higher brackets your choice gets more expensive. Some clients have chosen to convert a modest amount each year. In time it's a large tax-free account! Wow, the American Dream!

New Broker Reports Caused Confusion

I saw more "Corrected" 1099 Forms this year than ever before. Part of the reason is the complexity of today's investments. Mutual funds invest in a variety of different companies. If any single company has a legitimate delay in closing its books, you'll see corrected earnings.

New Stock Sale Rules. New IRS rules added confusion. For years brokers have had to report stock sales. Until 2012, they only told IRS your *sale* amount, called "gross proceeds". *You* had to track original cost. The difference between cost and selling price gives either a gain or a loss. Many brokers have been reporting your gain or loss to *you*, but not to the IRS – until this year.

Worse, if you moved your account to a new broker, the cost of your securities was listed as "unknown".

Brokers Must Track. IRS wants better control. Starting in 2011 brokers had to start reporting your gain or loss. However, the new rules are "phased in". In 2011 they had to track stocks you *purchased* in 2011. If you change brokers, these records now must be passed on to the new broker. For items you purchased before 2011, tracking is still your job.

It gets more complicated. Only *stocks* were covered for 2011. For 2012, brokers must also track *mutual funds*, but only those bought in 2012 or later. Bonds and other investments won't fall under the rules until 2013.

"Covered" vs. "Non-Covered". You got multiple reports of your sales this past year from your broker. Your statement was divided into sales "covered" by the new rules, and sales "non-covered". Since only stocks had to be tracked in 2011, the only "covered" sales were short-term sales of stocks bought in 2011.

Your tax return also had a new Form 8949 to tell IRS which type of sale was being reported. This is all about IRS wanting control.

For 2012, we'll see a few long-term sales of stocks bought in 2011 – they are "covered" by the new rules. Some short-term sales of mutual funds will be "covered" in 2012.

The new rules are here to stay. Confusion will increase. Why? If you bought *anything* before 2011, only *you* can track its cost!

Kids & College

College education has big tax breaks, but – do they go to the parent, or the student? Some key ideas:

Dependency To Parent. Unless the youngster is self-supporting, the personal exemption is claimed by parent(s). For separated parents we look at "custody" – where does the youngster consider "home" to be?

Temporary Absence. Even while living away from home, a youngster is probably "domiciled" with the parent(s). This is true unless the student never intends to return.

Tax Benefits With Dependency. A twist in the tax laws. The valuable education credits must be taken on the same 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 help can only be claimed on the tax return where the exemption is claimed. For separated spouses, custodial parent can use a special tax form to waive a child's exemption to the other spouse – ability to claim education credits was also waived! This might be a valuable tax strategy where one spouse has too much income to get benefit from the credit.

"Kiddie Tax" Issues. Youngsters with investment income (interest, dividends, and capital gains) over $1,900 have extra rules. Above this limit the youngster pays tax at the higher of his/her own tax rates, or those of parent(s). Normally this means both tax returns must be done at the same time. Don't let the student file his/her own return!

Ends At Age 24. When youngster turns 24 things change. Kiddie Tax rules disappear. The student likely claims his own personal exemption, as much tougher tests apply if parent wants the deduction.

College is expensive, but the special tax breaks can be a big help. They can produce a direct tax cut of the first $2,000 spent, and 25% of the next $2,000.

Tips For You

Taxes Going Up? Lots of talk about tax increases lately. A group called *The Tax Foundation* studies our total tax burden. They measure a date called "Tax Freedom Day". It's the date when Americans will have earned enough to pay a year's worth of federal, state, and local taxes. In 2010 it fell on April 9. Last year it was April 14. This year – April 17. Worse, if we paid enough taxes to provide a balanced Federal budget, we'd work until May 14. After this, we can start paying our own bills!

Tracking College Costs. The American Opportunity Credit lets you claim more than just tuition costs. Books and supplies count. Many classes these days require a computer. This opens the door to software, on-line fees, supplies, even a new computer. Remember, the first $4,000 of combined costs gets the maximum credit. If tuition is low, or grants pay much of it, have the youngster help in tracking the extra costs. You'll be well paid.

Health Care Bill In High Court. The Supreme Court began hearings on the historic Health Care Reform Act in late March. The Bill requires all Americans to have an approved health care plan, or face stiff tax penalties starting as early as 2013. We won't know until the Court rules whether the Bill is supported in full, or divided into parts, with some approved and others not. After the Court rules, it'll take time to sort out the results. I'll do my best to give a clear explanation in a future issue.

Vacation? Rent Your Home! If you're taking a summer vacation, why not rent your home while away? Maybe you can pocket the money! Tax law allows you to rent out your own home for up to 14 days each year without declaring the income. Stick to this time frame, and you pay no tax on the income. Local papers and on-line services have listings for such rentals. The money will likely pay for a good bit of your own vacation. And – it's *legal*!

Collecting Unemployment? Unemployment benefits are taxable. We would both like to see you land a great job. But, in the meantime, you might consider having withholding done from your benefit. I saw folks who got a rude shock from the tax this year. Call me if you need help with the decision.

Over 70½? If so, you must take money from pension plans and IRA accounts each year. It's called your Required Minimum Distribution, or RMD. There are serious penalties if you don't take enough money out. The formula depends on your age at the end of 2012, and the amount of money in your account at the end of 2011. Your plan custodian sent you a letter in February to remind you of the amount. If you overlooked it, please give them a call.

Business Driving. For 2012 you may claim 55.5¢ per mile for extra business driving. It takes only 180 miles to get a $100 deduction! Look at meetings, client visits, trips to other sites, or shopping for supplies. It's your money!

Estimated Taxes. If you pay estimated taxes, perhaps you saw something in this issue that neither of us thought of when we set your payments. If you expect the tax bill might be higher or lower than we expected, please give me a call. It's easy to change the schedule of payments. I'd like to see you pay the smallest amount allowed with no penalty. This lets your money work for you, rather than for the IRS.

Be wary of strong drink. It can make you shoot at tax collectors - - - and miss!

Robert A Heinlein

Your Tax Calendar

June 15	2nd quarter estimated tax payments due.
Aug. 31	Forms 5500 due for pension or Keogh plans.
Sept. 17	3rd quarter estimated tax payments due.
Oct. 15	Extended returns for 2011 due.
Today	Be sure to call if you have large changes to income or deductions!

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