With another tax season put to bed, I wanted to send out a quick tax-related update surrounding common issues we've encountered while preparing client taxes, frequently asked questions, and a few key changes for 2011. Despite efforts to move the format and content of messages like this from email *sit-down meals* of information to Facebook / Twitter / Blog *on-the-go bites* of information, compliance issues have prevented me from being able to do it so far. As you can imagine, government regulations are a bit behind the times and the application of investment advisor law to social media isn't clear yet. I am hoping to make some more headway in that area in Q2 with or without clarification from regulators. For now, I will go the way of a bulleted list which hopefully reads a bit faster than a narrative message even though it's still a lot of information at once:

- As many of you have learned the hard way, fewer and fewer financial organizations are sending you hard copy tax documents anymore. Many documents are download only and others, like some mortgage interest statements are being combined into monthly account statements to save the cost of an additional mailing. The moral of the story is that as time goes on, you're not going to be able to just throw your tax documents in a box all through February and give the box to your tax preparer because it's going to be missing a lot of information. You're going to have to know what documents you're expecting and where to get them. If you miss a document and your preparer doesn't know to ask you about it, the IRS will send you a correspondence audit letter indicating missed income and additional tax, interest, and penalties, or you're going to miss a deduction (and by the way, the IRS isn't going to notify you about it in that case).

- The mileage rate for business mileage has increased from $0.50 to $0.51 per mile in 2011. In order to take the deduction, you cannot simply estimate your mileage for the year. You have to keep a mileage log, showing trips by date along with their business purpose. You must also record your non-business mileage for the year since your tax forms require that information. There are many cell phone "apps" to help you track business mileage. An excel spreadsheet or piece of paper work just as well. Also remember than commuting to your usual place of business each day does not count as business mileage.

- I received a lot of questions regarding charitable contributions and many of you opted not to take some deductions you deserved related to charitable contributions because you didn't maintain appropriate records. Here are some key things to know about charitable contributions:
    - For most people, every dollar you contribute saves you between 25 and 40 cents of tax. If you donate $1000, clean out your closet, and have some charitable expenses, you could easily be talking about $500-1000 of saved tax if you keep good records.
    - For non-cash charitable contributions, you have to keep an itemized list of what you donated and how much value you assigned to each item. Simply having a blank goodwill receipt with a date on it is not sufficient for a deduction from the IRS. Keep a list of what you donated and as even better supplemental evidence, take a digital picture of what you donated (e.g. spread the pile of clothes out on the floor and take a picture of them before you put them in the big bag or better yet, do it in front of the donation center!). The more evidence you have, the harder you will make it for an auditor to reverse your deduction. You can

estimate the value of your non-cash contributions using a variety of websites, one of which is included here.
    - Your time that is spent on a charitable purpose is not deductible. No way around this.
    - Your expenses that are spent on a charitable purpose are deductible if they're not reimbursed, they are directly tied to the charitable work, they are expenses you would not have had if it wasn't for charitable work, and they are not personal, living, or family expenses. In this case, you should keep all receipts and get an acknowledgement from the organization that states the services you contributed, that you were not reimbursed for your expenses (or what you were reimbursed for), and a listing of any benefits you received as a result of the work.
    - You can deduct mileage driven for charitable work, though the rate is reduced from the business mileage rate. The rate for 2011 is 14 cents per mile. Just like with business mileage, you must keep a written or electronic mileage log to claim the deduction.

- If you received a large (or even a small) refund from the IRS, it means you're letting the IRS hold your money for you for part of the year while paying you no interest. Generally, this is due to having too much tax withheld from your paychecks. Instead of overwithholding, you can reduce your withholding by claiming more allowances on your W-4 with your employer. This will increase the net amount in each paycheck and given you more of your money during the year.

- On the other side of the withholding coin, if you owed tax to the IRS, but you didn't owe too much tax to the IRS, you received an interest free loan from them for part of the year. Consider this a success. If you owed an underpayment penalty, then you received a loan at a 4% rate for part of the year (not terrible). In order to avoid paying an underpayment penalty, one of the following must be true:
    - You owe less than $1,000 in tax
    - You owe less than 10% of your total tax bill for the year
    - You paid through withholding or estimated tax payments, at least 100% of the tax you paid in the previous year (110% if your income is > $150k).

  If none of those conditions are met you will owe interest. To avoid this, you can either increase your withholding by reducing the number of allowances claimed on your W-4 with your employer, or make estimated tax payments to the IRS throughout the year (quarterly). Remember that earned income from work isn't the only thing that's taxed. Interest on bank accounts (though that's hard to come by these days), investment interest / dividends / gains, rental income, and self-employment income are all taxed and they don't have any withholding in most cases.

- If your financial advisor isn't tracking the cost basis of your investments and you're not tracking the cost basis of your investments, then you'll have a nightmare on your hands for tax purposes when you sell an investment. You are taxed on your gain. The only way to know your gain is to know what you paid for the investment. If you don't know and can't prove what you paid, you're taxed on the whole amount of the sale which can cause you to pay thousands of dollars of extra tax! (Of course, PWA tracks cost basis for investments for all our clients so you don't have to worry about this).

- If you own a home and you are an employee, you generally don't want to take a home office deduction. If you are a renter and/or if you are a business owner, then it may make sense for you to take a home office deduction. If you want to know why, feel free to contact me. Otherwise, just take my word for it. Note that you can't choose whether to take one or not. If and only if you have a dedicated space in your home that is used exclusively for work, then you have a home office and can/must take a deduction. You can of course control whether you have a dedicated space or not though.

- In 2009 and 2010, many taxpayers received the Making Work Pay tax credit which reduced their tax by $400 or $800 per year. This credit goes away in 2011. In its place is a payroll (social security / FICA) tax reduction from 6.2% of income to 4.2% of income. By 2012, this break will also expire. I don't expect any extensions or replacements of the credit / tax break.

- Many people are converting personal residences to rental properties in this environment of falling housing prices. If you do it make sure you capture the fair market value of your property on the day it becomes available for rent. You'll need this number for tax purposes if the value is lower than what you paid for the house. The ONLY way to determine this number for certain is by qualified appraisal. If you don't want to pay for a qualified appraisal, you can determine this value in whatever fashion you think you can justify to the IRS (comp sales, tax assessments, realtor opinion, etc.), but there is no guarantee the IRS will accept the number and it will impact your rental depreciation deduction and the gain or loss you'll claim when you eventually sell the property.

- Remember that you're only allowed to deduct rental losses in the current year if you make less than $150k of adjusted gross income. Make more than that and the loss is suspended until you make less, have rental income, or sell the property.

- The income limits for contributing to a Roth IRA in 2011 are $107k for single taxpayers (partial contributions are allowed for income over $107k but less than $122k), and $169k for joint filers (partial allowed up to $179k). Note that these income limits are based on adjusted gross income which excludes 401k contributions, pre-tax health insurance, investment losses (up to $3k), flex spending contributions, student loan interest, and a few other deductions so you may still qualify even if your salary is over the threshold. Note that all key tax numbers and phaseouts can be found on the PWA website under Resources. For those who don't have money in a traditional IRA, there is a way around these income caps. Contact me if you want to discuss.

- The 2011 tax brackets are little changed from 2010, but people are always asking me if they're close to the next bracket out of fear of jumping to the next bracket by just a few dollars and then actually earning less after tax. For your reference, the brackets are below (snipped from bankrate.com). Note that your entire income is not taxed at your marginal tax bracket. Your income is partially taxed in each bracket until you've made enough to bump you up to the next. So for example, if you're at the very top of the 28% tax bracket and make an extra dollar, it doesn't mean that all of your income suddenly gets taxed at 33%. Only that one extra dollar is taxed at 33%. So, contrary to popular belief, you will never have more after-tax income by earning less.

- One last note on tax brackets… you'll notice below that the married tax brackets are not double the single tax brackets for middle and upper income taxpayers. This is commonly known as the marriage penalty and it means that if two working individuals get married, they will pay more tax together than they would if they remained single. Also notice that the married filing separately tax brackets are not the same as the single tax brackets (they're actually half of the married filing jointly tax brackets) which means that filing separately does not eliminate the marriage penalty. I'd venture a guess (though I have no proof) that > 90% of newly married couples don't know this and are surprised when they owe money to the IRS the first year they're married because they did not adjust their withholdings to account for the marriage penalty.

2011 tax rates

Tax rate	Single filers	Married filing jointly or qualifying widow/widower	Married filing separately	Head of household
10%	Up to $8,500	Up to $17,000	Up to $8,500	Up to $12,150
15%	$8,501 - $34,500	$17,001 - $69,000	$8,501- $34,500	$12,151 - $46,250
25%	$34,501 - $83,600	$69,001 - $139,350	$34,501 - $69,675	$46,251 - $119,400
28%	$83,601 - $174,400	$139,351 - $212,300	$69,676 - $106,150	$119,401 - $193,350
33%	$174,401 - $379,150	$212,301 - $379,150	$106,151 - $189,575	$193,351 - $379,150
35%	$379,151 or more	$379,151 or more	$189,576 or more	$379,151 or more

If you have any questions about the information above, any other tax-related issues, or anything else, feel free to contact me.

Thanks,
Tom