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Client Information Bulletin

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Key Provisions in the New Tax Act *New tax breaks across the board*

The recent tax law—the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010—provides a wide array of tax breaks for individuals, businesses and estates, in addition to extending unemployment benefits. Here’s a brief summary of the key tax provisions in the new law.

Income tax rates: The 2010 tax law preserves the current income tax structure through 2012. Without this extension, the bottom 10% rate would have been eliminated, and the two top rates of 33% and 35% would have increased to 36% and 39.6%, respectively. The new law also incorporates relief from the “marriage penalty” affecting joint filers.

Capital gains and dividends: The “Bush tax cuts” are extended through 2012. Under the 2010 tax law, long-term capital gains and qualified dividends will continue to be taxed at a maximum tax rate of 15% (zero percent for lower-income individuals). Without this extension, the maximum tax rate for long-term capital gains would have increased to 20% (10% for lower-income individuals), while qualified dividends would have been taxed at ordinary income rates.

Payroll tax holiday: The 2010 bill authorizes a one-year “payroll tax holiday” for workers. For 2011 only, the employee’s share of the 6.2% Social Security tax is reduced by 2% for

wages received up to the annual wage base of \$106,800. A comparable 2% cut for Social Security tax is available to self-employed individuals in 2011.

Alternative minimum tax: The alternative minimum tax (AMT) is determined by a complex calculation involving certain tax preferences, adjustments and an exemption amount based on filing status. The new tax law bumps up the AMT exemption amounts for 2010 and 2011, instead of the scheduled return to pre-2001 levels.

Itemized deductions and personal exemptions: Under prior law, deductions for itemized deductions and personal exemptions were phased out for certain high-income taxpayers. The phaseout rules were repealed for 2010 but were scheduled to return in 2011. Now the new tax law extends the repeal of the phaseout rules for itemized deductions and personal exemptions through 2012.

Section 179 deduction: Under the 2010 small-business law (the Small Business Jobs Act of 2010), the maximum Section 179 deduction was doubled from \$250,000 to \$500,000 for qualified business property placed in service during tax years beginning in 2010 and 2011. The phaseout threshold was also increased from \$800,000 to \$2 million. The new tax law provides a \$125,000 maximum deduction and \$500,000 phaseout threshold for tax

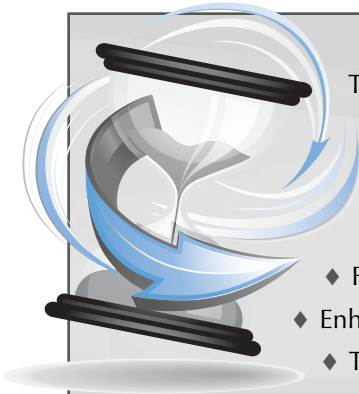
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Back to the Future

The new tax law retroactively extends several tax law provisions through 2011. The following tax breaks, which had officially expired after 2009, are available dating back to January 1, 2010.

- ◆ Tax-exempt distributions of IRA funds used for charitable donations (limited to taxpayers age 70½ or older)
- ◆ State and local sales tax deduction (in lieu of state income tax deductions)
- ◆ Faster write-offs for qualified leasehold, restaurant and retail building improvements
- ◆ Enhanced charitable deductions for donated property used for conservation
- ◆ Tuition deduction for higher education expenses
- ◆ Research credits
- ◆ Deduction for educator “classroom expenses” (limited to \$250)

Note that the new tax law does not extend the additional standard deduction for property taxes paid by nonitemizers.

years beginning in 2012 instead of dropping to \$25,000 and \$200,000, respectively.

Bonus depreciation: The 2010 small-business law also reinstated 50% “bonus depreciation” for qualified property placed in service through 2010 (through 2011 for certain other property). Thanks to the new tax law, your business can claim 100% bonus depreciation deduction for qualified property placed in service before 2012 (before 2013 for certain other property); and 50% bonus depreciation for qualified property placed in service in 2012.

Qualified small-business stock: Under prior law, an investor could exclude a maximum of 50% of the gain from the sale of “qualified small business stock” (QSBS) held more than five years. The maximum exclusion was temporarily increased to 75%. Now the new tax law authorizes a maximum 100% exclusion for QSBS acquired before January 1, 2012.

Higher education credit: The enhanced American Opportunity Tax Credit (AOTC), which was scheduled to expire after 2010, is extended through 2012. The maximum annual credit of \$2,500 is available for four years of postsecondary school study. However, the AOTC is phased out for certain high-income taxpayers.

Child tax credit: The new tax law extends the enhanced child tax credit through 2012. It was scheduled to expire

after 2010. Without the new law changes, the \$1,000 credit would have dropped to \$500 per qualified child.

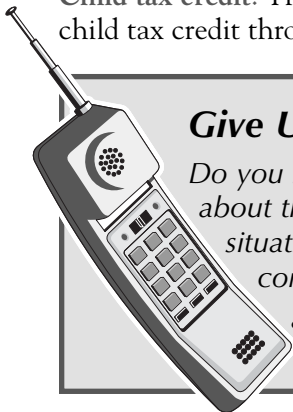
Adoption credit: The new tax law extends the credit for qualified adoption expenses through 2012 (but without enhancements included in the 2010 health care legislation). The maximum credit amount for 2011 and 2012 is \$12,170. Without the new law changes, the maximum credit would have dropped to \$5,000. However, the credit is phased out for certain high-income taxpayers.

Residential energy credits: Under prior law, you could claim a 30% residential energy credit (increased from 10%) for qualified energy-saving improvements in the home. The maximum credit for 2009 and 2010 combined was \$1,500. The credit was set to expire after 2010. The new tax law allows a 10% residential energy credit through 2011 with certain other modifications.

Estate-tax relief: The estate rules have been completely revamped. The new tax law revisions generally apply through 2012. Beginning in 2011, estates may benefit from a \$5 million exemption, a top tax rate of 35%, repeal of modified “carryover basis” rules and unification of the estate- and gift-tax systems. In addition, the estate-tax exemptions will be “portable” between spouses for decedents dying in 2011 or 2012. The new law also includes comparable changes for the “generation-skipping tax” affecting most transfers to grandchildren.

Note that the one-year repeal from federal estate tax still applies to decedents dying in 2010. However, an executor can choose to use the new rules taking effect in 2011 for a decedent who died in 2010 if it suits the family’s needs. Obtain professional guidance.

Reminder: This is only an overview of the main tax provisions in the new tax law. This publication will provide more information on these and other tax breaks in upcoming issues.



Give Us A Call!

Do you have any questions or comments about this newsletter or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.

Which Business Entity Is Best for You?

Pros and cons of different business structures

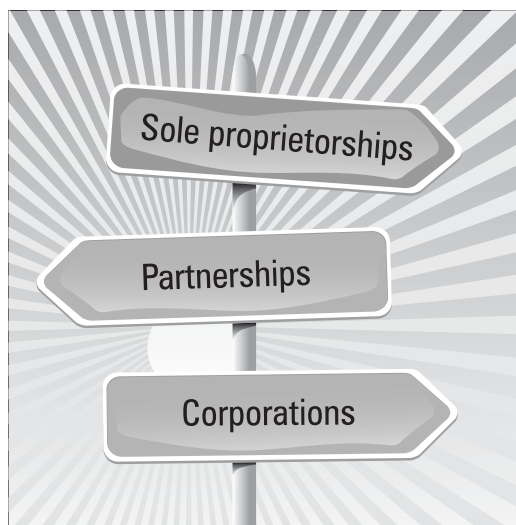
As you are probably well aware, there are several different types of business entities. Which type best suits your current needs? The following is a summary of the main points:

Sole proprietorships: This structure may be used for a firm owned and operated by a single person. Because you have no other partners or shareholders, you maintain complete control of the business. Basically, you reap all the rewards, but you also run all the risks.

A major disadvantage is that you have unlimited personal liability. However, you can reduce the risk by purchasing adequate insurance coverage. It also may be more difficult than a partnership or corporation to obtain financing.

Partnerships: Each general partner faces unlimited personal liability for all partnership debts. All partners must agree before an interest can be transferred, and any one partner can cause a dissolution.

The death of one of the partners may cause the business to dissolve. However, a partnership agreement can provide for a new partnership to spring into existence upon the death of a partner. In essence, the surviving partners “buy out” the deceased partner’s interest. This buyout is usually funded through life insurance. **Important:** The partnership agreement should include a method for valuing a partner’s interest.



As far as taxes are concerned, the partnership’s profits or losses are reported on each partner’s individual tax return.

Corporations: A corporation is a separate legal entity. This type of structure limits your liability to the amount of your investment. A corporation has a guaranteed continuity of life, shares can be freely sold or transferred, and it has the ability to raise capital through the sale of stock.

However, a traditional C corporation triggers double taxation: once at the corporate level and once when dividends are distributed to the shareholders.

One solution is to distribute income in ways other than taxable dividends, such as salaries, debt repayment, etc. Of course, the IRS limits deductions for wages to “reasonable” amounts for services actually rendered.

Note: Shareholders may be held personally liable in some cases. This is known as “piercing the corporate veil.” Generally, this occurs when a court finds commingling of assets, a lack of corporate formalities or extreme undercapitalization.

There are several different categories of corporations, including the following:

- ◆ **Close corporations:** All the shareholders must consent to a transfer of stock. In this respect, it is similar to a partnership. Usually, the number of shareholders in a close corporation is limited.

- ◆ **S corporations:** Generally, this status provides insulation from liability while affording tax benefits. **Reason:** An S corporation is not subject to double taxation. In brief, the shareholders are taxed like partners in a partnership. State law may have an impact.

- ◆ **Limited liability companies:** This entity blends corporate and partnership characteristics. Generally, a limited liability company (LLC) is taxed like a partnership. At the same time, owners of interests in the company (called members) receive the protection of limited liability. **Caution:** Once again, state law may affect your decision.

Each situation should be analyzed on its own merits. Make an informed decision with professional assistance.

New Twists to FSAs

New rules for flexible spending accounts (FSAs) take effect in 2011.

For health care FSAs, funds can no longer be used for over-the-counter drugs and medications, unless specifically prescribed by a physician. However, employees may continue to withdraw funds to pay for medical supplies.

If your employer permits it, you can use amounts left in your account from 2010 to pay for qualified expenses up until March 15, 2011. Any remainder is forfeited.





Tax Breakdown of Interest Expenses

What you can deduct on 2010 returns

Did you pay any interest expenses last year? The interest may be wholly deductible, partially deductible or not deductible at all. Generally, the amount of the deduction depends on the use of the loan proceeds. Here's the basic breakdown for the 2010 tax year:

Mortgage interest: As a general rule, you can deduct "qualified residence interest" paid during the year. To qualify, you must be legally obligated to pay the mortgage, and the mortgage must be secured by a qualified home (i.e., your principal residence and one other home). The deduction limit depends on whether the debt is an acquisition debt or a home equity debt.

◆ **Acquisition debt:** This is a debt incurred to buy, build or improve a qualified home. The interest paid on up to \$1 million of acquisition debt is fully deductible.

◆ **Home equity debt:** Other qualified debt, such as a home equity loan or line of credit, is treated as a home equity debt. The interest paid on up to \$100,000 of home equity debt is fully deductible. Unlike other types of interest, the interest on home equity debt may be deducted no matter how the loan proceeds are used.

Note: In a new ruling, the IRS says that acquisition debt exceeding the \$1 million limit can be treated as home equity debt up to the \$100,000 limit. Thus, the total limit is effectively \$1.1 million.

Investment interest: If you borrow funds to buy property held for investment purposes (e.g., securities or real estate), the interest paid on the loan is treated as

investment interest. The amount of investment interest you can deduct is generally limited to the amount of your "net investment income" for the year. Any excess is carried over to the next year.

Net investment income includes gross income from property held for investment, such as interest, annuities and royalties. It does not include capital gains and qualified dividends eligible for tax-preferred treatment. The maximum tax rate for long-term capital gain and qualified dividends in 2010 is 15%, as opposed to ordinary income taxed at rates up to 35%. However, you can elect to include long-term capital gain and qualified dividends as net investment income if you forfeit the preferential tax rate.

Business interest: The interest incurred in a trade or business, or in the production of rental or royalty income, is fully deductible—no questions asked and without limits.

Personal interest: If an interest expense doesn't fall into one of the other categories, it is generally treated as personal interest (although certain exceptions may apply). Personal interest is nondeductible. However, there is a key exception for interest paid on student loans. In brief, you can claim a limited deduction for interest paid for qualified higher education expenses if the loan is in your name. The maximum annual deduction of \$2,500 is phased out for high-income taxpayers.

Reminder: This is only a brief summary of the main rules. Seek guidance when filing your 2010 tax return.

Facts and Figures

Timely points of particular interest

➔ **Getting a Tax Workout**—In a new ruling, the IRS says that the cost of a gym membership may be claimed as a deductible medical expense. To qualify, you must have been diagnosed with a specific disease or illness and are using the facility to alleviate or treat the condition. **Caveat:** The cost is not deductible if you are merely improving your general health at the gym.

➔ **Be on Time**—Are your workers often tardy? They may be taking their cue from the boss. Although you probably work more hours overall than other employees, try to set a high standard by being punctual in the morning. If employees see that you consistently arrive late, they may think it is okay for them to do the same. Similarly, do not always leave promptly at the end of the business day.

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