The Financial Navigator – August Newsletter

This month's topic is taxes, not the most exciting topic especially during the vacation days of summer, but with the significant tax law changes coming up in 2011, I thought it would be worthwhile to highlight, or lowlight depending on your point of view, some of the major changes that are right around the corner. In addition, this topic will be the issue de jour during the upcoming fall elections, so hopefully this information will help you cut through the rhetoric and focus on what you believe will help secure your family's financial future, and perhaps the country's.

Please feel free to forward this newsletter to any individuals that you may think might be interested. Thanks and enjoy the remainder of the summer.

Sincerely,
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Upcoming 2011 Tax Changes

In just six months, one of the largest tax hikes in the history of America is scheduled to take effect. Now there is some discussion about altering the increases, keeping the current rates for the middle-class, targeting investment income for higher taxes, targeting only the 'rich'; however, to date nothing has been done and with the summer recess and elections there is some doubt Congress will accomplish anything before December 31rst, 2010. So potentially, the scheduled tax increases will hit families and small businesses in three waves on January 1, 2011:

First Wave: Expiration of 2001 and 2003 Tax Relief

In 2001 and 2003, the GOP Congress enacted several tax cuts for investors, small business owners, and families, these will all expire on January 1, 2011:

Personal income tax rates will rise. The top income tax rate will rise from 35 to 39.6 percent (this is also the rate at which approximately two-thirds of small business profits are taxed). The lowest income rate will rise from 10 to 15 percent. All the rates in between will also rise, and itemized deductions and personal exemptions will again phase out, which has the same mathematical effect as higher marginal tax rates as the bottom-line tax bill on page 2 of your 1040 will increase. The full list of marginal rate hikes is below:

- The 10% bracket rises to an expanded 15%.
- The 25% bracket rises to 28%.
- The 28% bracket rises to 31%.
- The 33% bracket rises to 36%.
- The 35% bracket rises to 39.6%.

Higher taxes on marriage and family - The marriage penalty (narrower tax brackets for married couples) will return from the first dollar of income. The child tax credit will be cut in half from $1000 to $500 per child. The standard deduction will no longer be doubled for married couples relative to the single level. The dependent care and adoption tax credits will be cut.

The return of the Death Tax - This year, there is no death (i.e. estate) tax. For those dying on or after January 1 2011, there is a 55 percent top death tax rate on estates over $1 million. A person leaving behind one home, some retirement accounts, and life insurance could easily pass along a death tax bill to their loved ones, get your estate planning done before the end of 2010.

Higher tax rates on savers and investors - The capital gains tax will rise from 15 percent this year to 20 percent in 2011. The dividends tax will rise from 15 percent this year to 39.6 percent in 2011.

Second Wave: Healthcare Reform Tax Increases

To help pay for healthcare reform several subtle and little publicized tax deductions and tax favored health savings accounts were eliminated, some will start to hit your tax return next year, a few of which are listed below:

- For those incurring significant medical costs, your ability to deduct these expenses will be decreased. This legislation increases the adjusted gross income threshold for claiming an itemized deduction from 7.5 percent to 10 percent.

- Your employer paid portion of health insurance will be included on your W2's, but not considered income. Starting in 2011, your W-2 tax form sent by your employer will be increased to show the value of whatever health insurance you are given by the company; your gross will go up by the amount of insurance you get. Once Uncle Sam starts tracking how much is paid in insurance how long do you think it will be before health insurance premiums are taxed?

- You will no longer be able to use health savings account (HSA), flexible spending account (FSA), or health reimbursement (HRA) pre-tax dollars to purchase non-prescription, over-the-counter medicines (except insulin).

- The legislation also imposes a cap on flexible spending accounts (FSAs) of $500 (currently, there is no federal government limit).

- The HSA Withdrawal Tax Hike - This provision of increases the additional tax on non-medical early withdrawals from an HSA from 10 to 20 percent, disadvantaging them relative to IRAs and other tax-advantaged accounts, which remain at 10 percent.

- Starting in 2013, a 0.9% Medicare surtax will apply to wages in excess of $200,000 for single taxpayers and over $250,000 for married couples.

- Investment tax rates on high earners rates will take another hit in 2013 as for the first time investment income of households with an income of $250,000 or higher will be hit with the 3.8 percent Medicare tax. Therefore taxes on capital gains and dividends will move from 15% to a range of 23%-40% plus.

Third Wave: The Alternative Minimum Tax and Employer Tax Hikes

The Alternative Minimum Tax, AMT, was originally created in 1969 to ensnare a handful of taxpayers and ensure they 'pay their fare share'. Next year the AMT will ensnare over 28 million families, up from 4 million last year. These families will have to calculate their tax burdens twice, and pay taxes at the higher level, in addition some other aspects of the AMT, individual and business taxes will increase.

- The AMT small business expensing will be slashed and 50% expensing will disappear. Small businesses can normally expense (rather than slowly-deduct, or depreciate) equipment purchases up to $250,000. This will be cut all the way down to $25,000. Larger businesses can expense half of their purchases of equipment. In January of 2011, all of it will have to be depreciated.

- Taxes will be raised on all types of businesses; the biggest tax increase is due to the loss of the research and experimentation tax credit.

- Tax Benefits for Education and Teaching Reduced - The deduction for tuition and fees will not be available, and tax credits for education will be limited. Teachers will no longer be able to deduct classroom expenses. Coverdell Education Savings Accounts will be cut. Employer-provided educational assistance is curtailed. The student loan interest deduction will be disallowed for hundreds of thousands of families.

- Charitable Contributions from IRAs no longer allowed. Under current law, a retired person with an IRA can contribute up to $100,000 per year directly to a charity from their IRA. This contribution also counts toward an annual required minimum distribution, this will be eliminated.

Pay close attention to developments in Washington around taxes and as the year progresses you may want to factor in some of these tax increases when you speak with your tax and investment advisor. In order to try and lower the tax impact on your personal income you might consider taking capital gains in 2010 instead of holding onto the gains, or ensure your bonus is paid in 2010 vs. delaying it into 2011. Maximizing education expenses in 2010 is also another consideration. But the bottom-line is this is not just about taxing the 'rich'; the middle class will be hit by many of the increases mentioned above unless Congress acts as promised during the election.

If you have any questions on this topics, or need some help with other financial issues you are facing give me a call at (603) 373-8793.