



# Jodee Paape & Associates, LLC

Tax Season Newsletter

January , 2011

## WHAT A YEAR!

Congress did their best to keep things interesting this year. We had several major tax bills throughout the year, but it took them until December 17<sup>th</sup> to take care of many of the rules that impact the majority of taxpayers. Most of the rule changes were retroactive to January 1, 2010. Look for a more complete analysis inside this newsletter and on our website.

## SECURE PORTALS & WEB ORGANIZERS

We have the ability to set up a secure portal for you to access your tax returns and other documents. Anything you would normally receive from us on paper can be available on the portal including the organizer. We also can use the portal to exchange files – for example, scanned documents or an Excel file. If you'd like to receive your tax return on your portal, please indicate this on your organizer (bottom of the Questions section). This portal is available through the same type of technology used for internet banking. It is very secure and hosted by our software provider, Thomson Reuters. The data (and a backup) is housed in two underground bunkers in Eagan that are built to withstand any number of disasters. There is no charge for your portal – you'll be helping us all by going green!

## FILING DEADLINE CHANGED

Because of Emancipation Day (an official holiday in Washington, DC), the traditional April 15 filing deadline has been extended to Monday, April 18, 2011. We thought about keeping that information to ourselves, but we figured the media would clue you in ☺. Minnesota Revenue will also be observing the April 18 filing deadline this year.

## FEES

Last year we increased our fees. If you had been a client in the past, you received a "courtesy discount". This year our base fees have remained the same but some schedule fees have changed. The courtesy discount for your 2010 return will be one-half of your 2009 discount.

## SCHEDULING

Our hours January 24 through April 18:

- ❖ Monday thru Friday, 8:00 a.m. to 6:00 p.m.
- ❖ Saturday from 9:00 a.m. to 2:00 p.m.
- ❖ Evenings and Sunday by appointment only

## CONTACT US

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## ARE YOU A NEW CLIENT?

If you are a new client, please be sure to make an appointment. There is no additional charge for an interview and it helps us to learn more about your tax situation. Please bring us a copy of your last four years tax returns.

## CREDIT CARDS

As a courtesy to our clients, we offer you the opportunity to pay by credit card. We are happy to do so, but would like to share some information about the cost to us of processing credit card payments. We pay a base fee for every credit card charge. American Express and Discover charge us a much higher base fee so we've decided to accept only Visa or MasterCard. Because we are also charged a per item fee, we will accept credit card payments on charges over \$75. In addition, we are charged extra for "rewards" cards. Thanks for helping us to keep our overhead as low as possible!

## TAX SEASON PROCEDURES

When you are ready to file your tax return, please complete your organizer and return it to us along with your tax documents.

If you don't think you need an appointment, you can mail or drop off your documents. If you have any questions relating to your return, note them on a separate sheet of paper. We will call you when we begin preparing your return.

If you would like an appointment to discuss your tax situation, please call as soon as possible to request an appointment with Jodee, Lynne or Deb. If you already have an appointment, a notice indicating your appointment time was mailed separately.

**\*\* It is very important that you include all tax documents along with your organizer! \*\***

When we have finished your return, we will mail you a summary of the results and a two year comparison to last year's tax return. If you have questions about the results, please call or email us. As soon as possible after you receive this notification, you should come to the office to pay your preparation fee and pick up your copy of the tax return (if you've requested a paper copy), your original source documents you provided to us and the electronic filing authorization form. If you are married, **both** spouses need to sign the form but only one of you needs to come pick it up. The completed form can be faxed or mailed back to us. We can **NOT** file your return until the authorization form has been signed and returned to us.

## INFORMATION DEADLINE IS MARCH 19<sup>th</sup>

We need enough time to do a professional job on your return – that is what you are paying us for. We have developed a process that results in a quality, thoroughly reviewed tax return. In order to maintain this standard for ALL returns, we sometimes have to extend selected tax returns. The extension is automatic and allows an additional six months before the return has to be filed (October 15). This is NOT an extension of time to pay, however. If you owe, you must pay by April 18 in order to avoid penalties and interest.

Information received after March 19 may require that an extension be filed for your return. There will be an extra charge to calculate your extension. We will notify you by April 14 if we need to extend your return.

## SERVICES WE PROVIDE

**Notary Public** – We do have a notary available for our clients. Please call first to be sure Mary Anne is available when you need something notarized. Remember we need to follow the rules – please do not ask us to notarize something unless the individual signing is able to sign in our office.

**Basis Calculation** – It is very important to understand the cost basis of your investments held outside of retirement accounts. In order to make good tax planning decisions and certainly in order to calculate your tax correctly once an asset is sold, you need to know what your "tax basis" in the asset is. This is normally what you paid for the stock, plus any dividends reinvested. If you inherited the stock, the basis may be different. We will help you calculate the basis of your taxable stock holdings. We charge \$100 per hour for this service.

**Third Party Disclosures** – The issue of disclosure of personal and confidential taxpayer information is a growing concern. Effective January 1, 2009 the IRS has imposed new requirements for us to obtain written authorization from you, the taxpayer, before we can disclose any information to a third party. That authorization must be specific for each instance that disclosure is made. In plain English, the new rules mean we must obtain a signed authorization from you (both of you if you are married) **before** we can discuss your situation with a broker, banker, lawyer, real estate professional, financial advisor, etc. The language must be very specific and the penalties are severe if we don't follow the rules. We have a sample disclosure on our website that you can print out and fill in, or you can ask us to prepare one for your specific situation.

**Consent to Use of Tax Return Information** – We need to have your consent to use the information on your tax return for purposes other than preparation and filing of your tax return. Be assured we will NEVER authorize the use of your information by any third party unless you've given us specific consent (see above). We do, however, want to keep you informed regarding tax law changes, remind you to pay your estimates, invite you to seminars, etc. In order to legally contact you we need your consent. We appreciate your cooperation.

## TAX NEWS

### **Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (Signed 12/17/10)**

As the name implies, this is a sweeping tax package that includes, among many other items, an extension of the Bush-era tax cuts for two years, estate tax relief, a two-year “patch” of the alternative minimum tax (AMT), a two-percentage-point cut in employee-paid payroll taxes and in self-employment tax for 2011, new incentives to invest in machinery and equipment, and a host of retroactively resuscitated and extended tax breaks for individuals and businesses. Here’s a look at some elements:

The current income tax rates will be retained for two years (2011 and 2012) with a top rate of 35% on ordinary income and 15% on qualified dividends and long term capital gains.

Employees and self-employed workers will receive a reduction of two percentage points in Social Security payroll tax in 2011, bringing the rate down from 6.2% to 4.2% for employees, and from 12.4% to 10.4% for the self-employed.

A two-year AMT “patch” for 2010 and 2011 will keep the AMT exemption near current levels and allow personal credits to offset AMT. Without the patch, an estimated 21 MILLION additional taxpayers would have owed AMT for 2010.

The child tax credit and American Opportunity tax credit (see next page for more) will be retained in their present form for the next two years.

Many of the traditional tax extenders are extended for two years, retroactively to 2010 and through the end of 2011. Among many others, the extended provisions include the election to take sales tax as an itemized deduction in lieu of state and local sales tax; the \$250 above-the-line deduction for certain expenses of elementary and secondary school teachers; the above-the-line deduction for qualified higher education expenses.

After a one-year hiatus, the estate tax will be reinstated for 2011 and 2012, with a top rate of 35%. The Federal exemption amount will be \$5 million per individual in 2011 and will be indexed to inflation in following years (Minnesota exemption is only \$1 million). Estates of people who died in 2010 can choose to follow either 2010 or 2011 rules. The Gift Tax exclusion (currently \$1 million) will be reunified with the estate tax exclusion to be \$5 million in 2011.

The provision that permits tax-free distributions to charity from an Individual Retirement Account (IRA) of up to \$100,000 per taxpayer, per tax year was also retroactively reinstated and extended to include 2011. Individuals will be allowed to make charitable transfers during January of 2011 and treat them as if made during 2010.

The phaseout on personal exemptions and itemized deductions for taxpayers whose adjusted gross income exceeded specific threshold amounts have gradually been reduced to the point where they were eliminated for 2010. The new act extends that elimination for another two years – through 2012.

Premiums a taxpayer paid or accrued during the tax year for qualified mortgage insurance in connection with the purchase of a primary residence are deductible (subject to phaseout rules for certain taxpayers). The 2010 Act extends this deductibility for an additional year – through 2011.

**NOT RENEWED** – A property tax deduction for non-itemizers beyond 2010 tax returns. If you don’t itemize deductions but own a home, you’ve been able to deduct 50% of your property taxes (to a maximum of \$1000) in addition to your standard deduction. That will not be the case beyond 2010.

### **Residential Energy Property Credit**

This nonrefundable energy tax credit is available to those who make certain energy efficient improvements to their primary existing home. For 2009 and 2010 the law increased the credit rate to 30% of the cost of all qualifying improvements and raised the maximum credit limit to \$1,500 for improvements placed in service in 2009 and 2010. The credit applies to improvements such as adding insulation, energy efficient exterior windows and energy efficient heating and air conditioning units.

For 2011 we go back to the credit structure and rates which were in effect for 2006 and 2007. The credit will be 10% of the energy improvement (NOT including installation) subject to a maximum credit of \$50 for each main air circulating fan; \$150 for each natural gas, propane or oil furnace or hot water boiler; \$200 for energy efficient windows; and \$300 for each item of energy-efficient building property. There is also a cumulative lifetime limit of \$500.

The rules are complex and confusing – just be sure to include information on exactly what was purchased. If we’ve done your taxes since 2006, we’ll have the information we need on your lifetime limits. If not, please include that information for us as well.

## **Roth Conversions**

If you converted an IRA to a Roth in 2010, you will have many choices to make prior to filing your tax return. Be sure to make an appointment to discuss your options.

## **Education Benefits**

The "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" includes a two-year extension of the American Opportunity tax credit for college costs. Added to the tax code in 2009 as a temporary replacement of the previous Hope tax credit, the American Opportunity credit both increased the tax relief available for students from middle-income families and extended relief for the first time to students from lower-income families.

Now that the American Opportunity credit has been extended for two years, it might be a good time to review the tax benefits available under that credit, with an eye to how it compares with the Hope credit, which would have been in effect over the next two years had the American Opportunity credit not been extended.

Families with a family member in college can benefit from a tax credit for tuition and fees. From a taxpayer's point of view, a credit is almost always preferable to a deduction, because a credit reduces taxes owed, while a deduction only reduces taxable income. The maximum amount of the American Opportunity credit is \$2,500 (up from a maximum of \$1,800 under the Hope credit). The credit is 100% of the first \$2,000 of qualifying expenses and 25% of the next \$2,000. The maximum credit of \$2,500 is reached when a student has qualifying expenses of \$4,000 or more.

While the Hope credit was only available for the first two years of undergraduate education, the American Opportunity credit is available for up to four years. In both cases, the students must attend school full time and not have a felony drug conviction.

Under the Hope credit, qualifying expenses included just tuition and fees required for the student's enrollment. Textbooks were excluded, despite their escalating cost. The American Opportunity credit expands the list of qualifying expenses to include textbooks.

The Hope credit was nonrefundable. It could reduce your regular tax bill to zero but could not result in a refund. This meant that if a family didn't owe any tax it couldn't benefit from the credit, prompting critics to argue that the credit was unavailable to the families who needed it most. The American Opportunity credit addresses this criticism by providing that 40% of the credit is refundable. This means that someone who would qualify for the maximum credit of \$2,500, but has no tax liability to offset that credit, would qualify for a refund of \$1,000 (40% of \$2,500).

The Hope credit wasn't available to someone with more than moderate income. Under the credit's "phaseout" provision, taxpayers with adjusted gross income (AGI) over \$50,000 (for 2009) saw their credits reduced, and the credit was completely eliminated for AGIs over \$60,000 (twice those amounts for joint filers). Taxpayers with somewhat higher incomes can qualify for the American Opportunity credit, as the phaseout of the credit begins at AGI in excess of \$80,000 (\$160,000 for joint filers).

If you are not eligible for the American Opportunity Credit, the Lifetime Learning Credit (for part time students or students who have already claimed four years of Hope/American Opportunity Credit) and the Tuition and Fees deduction are still available as well.

## **Standard Mileage Rates for 2010 & 2011**

	<b><u>2010</u></b>	<b><u>2011</u></b>	
Business	50 ¢	51 ¢	per mile
Charitable	14 ¢	14 ¢	per mile
Medical	24 ¢	19 ¢	per mile
Moving	24 ¢	19 ¢	per mile

## **Minnesota Highlights**

Minnesota currently does not recognize many of the changes that have been made to federal law in the last few years. Some of the changes may be adopted when the Minnesota Legislature reconvenes. In general, if you are affected by this situation you will need to file an additional schedule with your Minnesota return in order to make the necessary adjustments. We will notify you if you are affected by any of the provisions that may be modified by the legislature during the filing season.

# SPECIAL SITUATIONS

## **Do you have rental property?**

Beginning in 2011, you will need to issue a 1099 to anyone who provides services for your rental property and you pay them \$600 or more during the calendar year. For example, if you pay Joe's Repair Service \$750 to paint your rental unit, you will need to issue Joe a 1099 for the \$750 payment. We suggest that you obtain a Form W9 from Joe with his social security number and address BEFORE you pay him and be sure he understands you will be reporting the payment to the IRS. 1099s must be completed by January 31 of the following year. We are able to electronically file the 1099s. Let us know if you'd like us to help you with this new requirement.

## **Do you have gambling income?**

A recent IRS Chief Counsel Advice Memorandum provides new guidance on how casual gamblers can deduct wagering losses to the extent of gambling income. Previously, all gambling winnings were reported as income, with losses (limited to reported winnings) reported as an itemized deduction. There are several disadvantages to this approach – if you have Social Security income, more of it might have been taxable because of the addition to your adjusted gross income, you may not itemize deductions so therefore would not actually be able to deduct your losses, you might be subject to additional limitations because of the increase in your income, etc. The new Memorandum (validated by a court case) states that casual gamblers may recognize a wagering gain or loss at the time they “cash out” for the day. In other words, gambling winnings are netted per gambling visit. The measure of gambling income is not gross winnings. You can deduct gambling losses directly against the winning amount reported on Form W-2G during a period of continuous gambling and report the net amount on page 1 of Form 1040. Additionally, you may report losses (to the extent of your net winnings on page 1) as an itemized deduction. You must keep an accurate record of losses and winnings. Quick example: Larry enters a casino with a \$100 bill in his pocket, wins a \$2,000 jackpot which is reported on Form W-2G, continues playing until he leaves the casino with \$600. Larry will report a net of \$500 (\$2,000 winnings - \$100 initial wager - \$1,500 losses) on page 1 of his 1040. We have a new flyer that explains these rules in detail and gives examples of appropriate documentation. Ask for one.

## **Do you have earned income?**

In 2011 you will pay 2% less into Social Security. Instead of 6.2% of your W2 income, you'll pay 4.2% (your employer will still pay in 6.2% on your behalf). If you are self-employed, you'll pay 10.4% instead of 12.4%.

## **Do you have income earned in a different state?**

In general, income earned in a different state is taxed by that state as well as your resident state. You will receive a credit from your resident state for the tax you paid to the other state. Sometimes states have an agreement called reciprocity which means that earned income is not taxed by the non-resident state. Minnesota and Wisconsin used to have reciprocity (MN still has reciprocity with Michigan and North Dakota). Now that Minnesota and Wisconsin have ended their reciprocity agreement, anyone who lives in one of those states but works in the other will need to file returns in both states.

## **Are you a “snowbird”?**

Minnesota has developed a new definition of who is a Minnesota resident. Even if you are technically a resident of another state, if you meet their new definition, it is possible for you to also be considered a resident of Minnesota for income tax purposes. If you (or your spouse) were in Minnesota for 183 days or more during the year and you or your spouse owned, rented or leased a facility in Minnesota with cooking and bathing facilities that could be lived in year round, you are considered a Minnesota resident for the length of time you owned or leased the “home”. If you are married and live with your spouse, both you and your spouse are presumed to have the same state of residence for tax purposes. As you might imagine, Minnesota does not like to lose tax revenue to other states. They are aggressively pursuing taxpayers that claim to have established residency in another state, particularly when they still own a home in Minnesota.

## **Do you have mortgage interest?**

There are several rules regarding mortgage interest that may interfere with your ability to fully deduct your mortgage interest. For regular tax purposes, you may deduct “home mortgage” interest. A “home mortgage” is any loan that is secured by your main or second home as collateral for the loan. Home mortgages include first and second mortgages, home equity loans and refinanced mortgages. A loan secured by your third home is considered a personal loan (and therefore not deductible) unless the third home is used exclusively for business (such as a rental property) or investment purposes (such as an inherited house that sits vacant until sold). Debt not secured by the property is personal debt (and therefore not deductible). There are three types of deductible home mortgage interest – each with different limits on deductibility:

- Grandfathered debt is a mortgage taken out on or before October 13, 1987 and is fully deductible regardless of the amount of the debt or what the funds were used for.
- Acquisition debt is a mortgage taken out after October 13, 1987 to buy, build or substantially improve a main or second home. Total acquisition debt on your main and second home combined is limited to \$1 million at any time. The limit is reduced by any grandfathered debt. Debt over the limit may qualify as home equity debt.
- Home equity debt is a mortgage that does not qualify as either grandfathered debt or acquisition debt. Total home equity debt on your main and second home combined is limited to the smaller of \$100,000 or the total of each home’s fair market value reduced (but not below zero) by acquisition and grandfathered debt for each home. In today’s market with many homes now worth much less than what was paid for them, it is very possible to have non-deductible interest on a home equity mortgage.

Refinanced debt can be considered any of the three types of debt listed above depending on the following:

- Debt to refinance grandfathered debt is treated as grandfathered debt up to the balance of the old mortgage, but only for the term left on the debt that was refinanced.
- Debt secured by the home and used to refinance acquisition debt is treated as acquisition debt up to the balance of the old mortgage principal just before the refinancing. Debt used to substantially improve the home is also acquisition debt.
- Refinanced debt in excess of the old acquisition debt mortgage principal may qualify as home equity debt.

If you are subject to Alternative Minimum Tax, only grandfathered and acquisition debt on your main home is deductible. Interest on home equity debt and interest on any debt on your second home are not deductible.

In order to help determine the deductibility of your mortgage interest, you should put together a history of your mortgages and what the proceeds of each loan were used for.

## **Do you have Medicare prescription drug coverage?**

If you reached the “donut hole” in 2010, you should have received a payment of \$250 to offset the additional cost to you for your prescriptions. We’ll need to deduct the \$250 from your prescription costs if you itemize your medical expenses on your tax return.

## **Do you need to fill out a FAFSA?**

We have a new worksheet that will help you fill out the income tax section of the FAFSA.

## **Did you receive a First Time Homebuyer Credit?**

If the home is disposed of or ceases to be your principal residence, you must repay the credit to the extent that you had a gain on the disposition of the home. If you purchased your home after April 8, 2008 and before January 1, 2009 the credit must be paid back over fifteen years (unless the home ceases to be your principal residence). You must start paying back the credit with your 2010 tax return.

## **Do you have a spouse?**

Be sure to fill out the information on your organizer regarding the “tax matters” spouse – who we should contact with questions regarding your tax return.