By-Lined Article

LAST-MINUTE FILING TIPS FOR A SHIFTING TAX LANDSCAPE

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With the tax filing deadline now only days away (April 18 this year due to Emancipation Day in Washington, D.C.), we thought it would be helpful to share a few last-minute tax filing tips, with a bias twist. As a result of interaction this tax season with more than 500 lawyers who have engaged the tax compliance and planning services of the Tax Accounting Group, we can comfortably and confidently report a common theme.

Whether speaking with seasoned partners, experienced judges, veteran law professors or young and emerging associates, the questions and messages seem consistent. Questions, questions and more questions about personal tax matters abound. And with good reason.

Last year, Congress passed sweeping health care reform legislation, which included numerous tax provisions; the HIRE Act, which contained a number of meaningful hiring and business stimulus provisions; and the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010.

Thus, the complexity of tax law continues to increase, with no end in sight. In the last two years alone there have been more than 1,500 tax law changes. Tax compliance for the 2010 tax year has proven to be challenging. Based on our recent experiences and in the spirit of being helpful to the hard working lawyers reading this article and about to file their tax returns, we provide a list of last minute tax tips.

Select Individual Strategies

- **Mandatory E-Filing.** Beware of the E-Filing Mandate . New for this year, tax return preparers who file 100 or more federal individual returns are required to e-file those returns. There are many benefits to taxpayers, including increased levels of error free processing, faster refunds (received in as little as 10 days), no long lines to mail returns at the post office, and acknowledgment by the IRS of receipt of tax return within 48 hours. This should provide increased motivation for those still filing paper returns to jump on the e-filing bandwagon.

- **Self-Employed Health Insurance Deduction.** Self-employed health insurance deductions include insurance premiums paid to cover a child who was under 27 years of age at the end of 2010, regardless of whether the child qualifies as a dependent. New for this year, the health insurance premium is also deductible in calculating earned income from self-employment for purposes of the self-employment tax.

- **Itemized Deductions.** New for this year, the limitation on itemized deductions has been repealed and deductions can be fully utilized without adjusted gross income (AGI) limitations.

- **Personal Exemptions.** New for this year, the AGI phase-out rules no longer apply for personal exemptions. Be aware that when married taxpayers file separate returns, a spousal exemption can only be claimed when the spouse had no gross income and was not claimed as a dependent of another taxpayer. Even without the phase-out, it may be worthwhile to forgo the dependency deduction for a child in college, so that the child can claim the education credits on his or her return for expenses paid by the child. The tax savings to the child, who can then claim education credits that you may not be able to due to income limitations, may be greater than the value to you of the dependency exemption for the child. Note, however, that the child cannot claim a personal exemption for himself or herself if you are eligible to but do not.

- **Job Hunting Expenses.** Expenses incurred in seeking new employment in the same trade or business are deductible. Common deductible expenses include resume costs including postage, job counseling and referral fees; employment agency fees; telephone charges related to seeking new employment; and local and out-of-town travel expenses incurred for interviews, to the extent they are not reimbursed by the prospective employer. Note that job hunting expenses are deductible even if they do not result in a new position being offered or accepted. Also, accepting temporary employment during a job search in another line of work does not impact deductibility.

- **Moving Expenses.** If you moved more than 50 miles for your new job, you can deduct the cost of getting yourself and your household goods to the new area, including 24 cents per mile (plus parking fees and tolls) for driving your own car. Certain other timing requirements must be met, such as the period of employment test, which provides that to qualify for a moving expense deduction, you must have worked as an employee for 39 weeks during the 12-month period after arriving at the new location. Moving expenses are above the line deductions, available to those who do not itemize deductions.

- **Alternative Minimum Tax.** Exemption is increased to $47,450 for single taxpayers, $72,450 for joint filers and $36,225 if married and filing separately. Personal, non-refundable credits are still permitted to offset AMT as well as regular tax. Although not a permanent fix to the AMT, without the increase in exemptions, an estimated 21 million additional taxpayers would owe AMT for 2010.

- **Unemployment Compensation.** In 2010, unemployment compensation is fully taxable. The tax free portion has been eliminated.

- **Home Office Expenses.** Employees and self-employed individuals may be eligible to claim home office deductions. Taxpayers may deduct home office expenses if part of the home is used exclusively and regularly for business. The business use must also be for the convenience of the employer. Deductible expenses include the allocable portion of many traditional personal and non-deductible expenses, such as insurance, utilities, repairs, maintenance and depreciation. Those who believe they are eligible should consult with their tax advisors as this is an area subject to close scrutiny by the IRS.

- **IRA Contributions.** Consider contributing up to $5,000 ($6,000 if age 50 or older) to a traditional or Roth IRA, or a combination thereof before April 18, 2011. IRA deductions may be available for those covered by other plans subject to certain dollar limits and phased-out for single taxpayers with AGI between $56,000 and $66,000 and for joint filers with AGI between $89,000 and $109,000. Contributions up to $6,000 to a Roth IRA will be allowed for taxpayers with AGI less than $167,000 for couples and $105,000 for single taxpayers.

  For 2010, you can make a deductible IRA contribution even if you have no earned income. If your spouse is covered by an employer-provided retirement plan, you can still make a fully deductible IRA contribution as long as your joint AGI as specially computed does not exceed $167,000. To be deductible for the 2010 tax year, the IRA contribution must be made no later than your tax return due date, including extensions.

- **Roth IRA Recharacterizations.** Traditional IRAs converted to Roth IRAs are taxable on the portion that represents a return of nondeductible contributions. This may yield the unintended consequence of propelling a taxpayer into a higher tax bracket, presenting a difficult burden for taxpayers who have suffered a job loss or significant investment losses. While bonuses, severance payments and other income items typically cannot be reversed, taxable Roth IRA conversions can be reversed through a mechanism known as "recharacterization."

  Without the taxable income from the conversion, a taxpayer can avoid being taxed at a higher rate. The timing rules can be complex, so consult with your tax adviser prior to undertaking an IRA recharacterization.

  The deadline for recharacterizing a contribution or conversion is the extended due date of your tax return for the year of contribution or conversion, meaning you can recharacterize for 2010 by April 18, 2011, or if your return is extended, you have until Oct. 17, 2011, to recharacterize. Taxpayers who converted to a Roth IRA when their traditional IRA stood at a high valuation, but has since dropped to lower levels, may wish to consider this strategy, which will treat the initial taxable conversion as if it never occurred.

- **Roth IRA Income Limit.** Roth contributions may be allowed for those with AGI less than $120,000 for single taxpayers and $176,000 for joint filers. Contributions to Roth IRA are permitted even if the taxpayer is a participant in another qualified plan and is under 70½ years of age. Certain elements of Roth IRAs are complex, be sure to consult your tax adviser when considering a Roth IRA.

- **Retirement Account Minimum Distributions.** Minimum distributions from retirement accounts are required for 2010. If a taxpayer turned 70½ in 2010, a minimum distribution is required by April 1, 2011, or a 50 percent penalty may apply. If taxpayers find themselves in this situation, they should consult their tax advisers for possible remedies.

- **First-Time Homebuyers.** A tax credit is available, up to $8,000, for taxpayers who signed a sales contract prior to May 1, 2010, and closed prior to Oct. 1, 2010. Repayments commence in 2010 for taxpayers who claimed the credit in 2008 for home purchases. The credit cannot be claimed if the sales contract was signed after April 30, 2010. Only those who have owned a primary residence in the last three years qualify for the credit. The credit does not apply to a second or vacation home.

- **Longtime Homebuyers.** A $6,500 credit is available for homebuyers who have owned a home for a period of five consecutive years in the eight years prior to purchase. The credit applies to purchases made after Nov. 6, 2009.

Buyers must have entered into a binding contract to buy a home on or before April 30, 2010, and have closed on the home by June 30, 2010. Credit phases out for single taxpayers with AGI between $125,000 and $145,000 and for joint taxpayers with AGI between $225,000 and $245,000.

- **American Opportunity Education Credit.** The maximum education credit remains at $2,500. Education credit income phase-outs occur for single taxpayers with AGI between $80,000 and $90,000 and joint taxpayers with AGI between $160,000 and $180,000. This credit increased tax relief available for students from middle and, for the first time, lower income families. The credit is available for up to four years and is maxed out at $2,500 when a student has qualifying expenses of at least $4,000, which has been expanded to include textbooks.

- **Tuition and Fees Deduction.** You may deduct the qualified tuition and related expenses paid during the tax year for you or your spouse and dependents, subject to certain dollar limits. Crunch the numbers to determine the favorable benefit, the education expense deduction or education credit. Up to $4,000 of qualified higher education expenses are deductible, subject to the same income phase-outs as noted above. Keep in mind that in most situations, considering the phase-outs, tax credits are more beneficial as they are dollar for dollar reductions of tax liability, where a deduction provides a tax benefit only at the marginal rates of the taxpayer.

- **Adoption Tax Benefits.** The maximum adoption credit increased to $13,170, for out-of-pocket expenses for the legal adoption of a child. Keep in mind that taxpayers may claim both a credit and an exclusion for expenses of adopting a child. But they may not claim both a credit and an exclusion for the same expense. If qualifying expenses before the year the adoption becomes final, claim the credit for the year after the expenses are paid.

- **Child Tax Credit.** You may claim the often missed child tax credit of up to $1,000 per child. To qualify, you must have a qualifying child under age 17 years old and your modified AGI must be lower than $75,000 for single taxpayers and $110,000 for couples.

- **Section 529 Plan Expenses.** Computer equipment, Internet access and related services continue to qualify as qualified education expenses and can be withdrawn tax-free from your 529 plan.

- **Standard Mileage Rates.** New rates apply for use of a car: 50 cents per mile for business use of car, 16.5 cents per mile for medical reasons and for the cost of operating your car for determining moving expenses, and 14 cents for the use of a car for charitable purposes.

- **Energy Credits.** Homeowners who made energy efficient improvements may be able to claim a new credit of 30 percent of the cost of all qualifying improvements, up to $1,500. Keep in mind that only the cost of materials are eligible for the energy credit, installations costs do not qualify. Additionally, the improvements must meet certain manufacturer certification requirements, and taxpayers claiming energy credits must maintain the manufacturer certifications in their files. The tax credit for improvements to energy-efficient existing homes has been extended through 2010.

  For 2010, the amount of the tax credit is 30 percent (up from 10 percent last year) of the amount paid for qualified energy efficiency improvements during the tax year. Qualifying property includes small wind energy property, solar water heating property and geothermal heat pumps.

- **Foreign Financial Accounts.** With minor exceptions, foreign financial accounts must be reported to the IRS on Form TD F 90-22.1 and filed by June 30, 2011, by any person with a financial interest in or signature authority over the foreign account. Those not in compliance may be subject to civil and criminal penalties. The Internal Revenue Service has instituted various voluntary disclosure programs, allowing taxpayers who have not previously reported interests in foreign bank accounts to come into compliance with reduced penalties. Taxpayers who have interests in foreign bank accounts who are required to report and have not previously done so or who are not currently in a voluntary disclosure program should contact their tax advisors immediately.

- **Long Term Capital Gains.** Your children over the age of 18 may pay 0 percent tax on long term capital gains if they are in a 15 percent bracket with taxable income for single filers between $8,350 and $33,950, or married taxpayers filing jointly with income between $16,700 and $67,900. Properly applying this provision of the law can save up to approximately $10,000 in tax.

- **Sales Tax Deduction.** Taxpayers may deduct state and local sales taxes in lieu of income taxes.

- **Gain From Certain Small-Business Stock.** Exclude gain up to 100 percent for stock acquired after Feb. 17, 2009, and before 2011, and held for more than five years. The stock must be stock of a corporation with gross assets not exceeding $50 million and that meets certain other active business requirements.

- **Tax Refund Options.** Flexible options exist for receiving your 2010 federal income tax refund, including splitting your refund with direct deposits into multiple checking or savings accounts, receiving your refund as a paper check in the mail, although this option takes longer, or buying up to $5,000 in U.S. Series I Savings Bonds with your refund. Electronic direct deposit refunds are typically received within 7-10 days from receiving notice that the IRS has accepted your electronically filed tax return, significantly shorter than paper filed tax returns which take between six to eight weeks.

- **File Even If You Cannot Pay by April 18.** If you are unable to pay your tax liability in full by April 18, you should still timely file or timely extend your tax return. Failing to timely file will significantly increase penalties. There are various options for those who cannot afford to pay their tax liability, including expanded installment agreements and offers in compromise, which allow more taxpayers to qualify.

Select Business Strategies

- **Domestic Production Activities Deduction.** This deduction, allowed to all taxpayers, is computed as a percentage of net income from eligible activities, including, among others, the manufacture, production, or growth of tangible personal property, in whole or in significant part within the United States. The taxpayer must own the property that it is manufacturing or producing. Be careful in determining whether your business activities are eligible for the deduction. The deduction is 9 percent of qualified production activities income.

- **Increased First-Year Expensing.** Expense amount under Code Section 179 increased from $250,000 to $500,000 with a phase-out amount of $2 million for the purchase of certain qualified property, generally machinery, equipment and certain software. Certain real property is now also eligible for expensing.

- **Bonus Depreciation.** Fifty percent bonus depreciation is available for property placed in service in 2010. For qualifying business property acquired after Sept. 8, 2010, and placed in service before Jan. 1, 2012, the amount of bonus depreciation is increased to 100 percent. Because bonus depreciation does not have a phase-out limitation compared to the first-year expensing discussed above, taxpayers may prefer to depreciate property under bonus versus Code Section 179.

- **Cell Phones.** No longer considered listed property subject to specially unfavorable depreciation rules.

- **Startup Expenses.** If possible, consider keeping startup business expenses under $60,000 to maximize deduction of $10,000, otherwise a phase-out threshold begins at $60,000.

- **Research Credit.** Credit is available for expenditures related to qualified research expenses such as developing a new process, invention, formula, technique or similar property.

These are but a few of the new or newer laws and select strategies you may wish to consider as you either prepare to complete your 2010 tax returns or finalize your extension calculations. It is advisable to discuss the strategies included herein and other tax preparation matters with a qualified tax professional.

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