Alerts and Updates

What's New for Tax Year 2011 (When Filing in 2012)

January 25, 2012

The following are select tax topics affecting individuals and businesses for tax year 2011. Some of the provisions, implemented in prior years, continue as noted below.

Individuals

Itemized Deductions: The limitation on itemized deductions has been repealed, and deductions can be fully utilized without adjusted gross income (AGI) limitations. Limitation is scheduled to return in 2013.

Personal Exemptions: AGI phase-out rules continue to be inapplicable for personal exemptions. The personal exemption is $3,700 for 2011, an increase of $50. Phase-out based on AGI is scheduled to return in 2013.

Alternative Minimum Tax (AMT): Exemption increased to $48,450 for single taxpayers, $74,450 for joint filers and $37,225 if married and filing separately.

Reduced Tax Rates Continue: 2011 tax rates for individuals remain at 10 percent, 15 percent, 25 percent, 28 percent, 33 percent and 35 percent.

Payroll Tax Holiday: Reduced employee share of Social Security taxes under the Federal Insurance Contributions Act (FICA) reduced from 6.2 percent to 4.2 percent. This reduction in FICA also applies to the self-employment tax, reducing the rate from 15.3 percent to 13.3 percent. This provision is currently set to expire at the end of February 2012.

Capital Gains and Qualified Dividends: Capital gains and qualified dividends continue to be taxed at a maximum of 15 percent for both the regular tax and AMT purposes. For those in the 15-percent income tax bracket and below, the rate is zero. Long-term capital gains tax rates are scheduled to revert back to 20 percent in 2013.

Cost-basis Reporting by Brokers: Starting in 2011, brokers were required to track clients' purchases of stock, real-estate investment trusts and foreign securities, reporting the original cost to the IRS when the security is sold. Purchases of mutual funds, bonds, options and many exchange-traded funds were not required to be tracked for 2011. If taxpayers do not specify which securities are to be sold, brokers must report securities sales on a first-in, first-out basis.

Child Tax Credit: $1,000 child tax-credit amount will continue.

Refundable Child Credit Continues: For taxpayers with three or more qualifying children, the credit equals 45 percent of the family's first $12,570 of earned income.

Mortgage Interest Expense: Debt used to buy, construct or improve a home can be treated as both acquisition and home equity indebtedness—allowing taxpayers to deduct interest on up to $1.1 million of mortgage debt, even if all of it was used to purchase or build the home.

Mortgage Insurance Premiums: Premiums paid in connection with acquisition indebtedness relating to a taxpayer's qualified residence are deducted as qualified interest.

Gain on Sale of Primary Residence: New rules limit how much gain can be excluded under the general exclusion rules applying to the sale of a principal residence. Gain will be taxed on a pro-rata basis for any years after 2009 that the home was not used as a principal residence.

Educator Expenses: The $250 above-the-line deduction for teacher classroom expenses has been extended.

Standard Mileage Rates: For the period of January 1, 2011, through June 30, 2011, the standard mileage rates are $0.51 cents per mile for business use of car, $0.19 cents per mile for medical and moving purposes and $0.14 cents per mile for charitable purposes. For the period of July 1, 2011, through year-end, the standard mileage rates are $0.55.5 cents per mile for business use of car, $0.23.5 cents per mile for medical and moving purposes and $0.14 cents per mile for charitable purposes.

Roth IRA Conversions: Regardless of income, individuals may convert funds from retirement accounts, such as 401(k) or IRA accounts, to Roth IRAs.

American Opportunity Tax Education Credit Continues: Up to $2,500 credit per student for qualified higher-education expenses, such as tuition and cost of books. Phase-out begins at AGI of $80,000 for single filers and $160,000 for joint filers.

Deduction for Higher-Education Expenses Continues: Up to $4,000 of higher education expenses is extended for 2011. Phase-out begins at AGI of $80,000 for single filers and $160,000 for joint filers.

Coverdell Education Savings Accounts: Annual contribution limit is $2,000, and the money can be used to pay for elementary and secondary school expenses.

Tax-free IRA Distributions to Charities Continue: Taxpayers who are age 70 1/2 or older can make tax-free distributions to a charity from an IRA of up to $100,000.

Retirement Savings Plans Continue: 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 to $66,000 and for joint filers with AGI between $90,000 and $110,000.

Roth IRA Income Limit Continues: Roth contributions may be allowed for those with AGI of less than $120,000 for single taxpayers and $179,000, for joint filers.

Tax Benefits for Adoption: Maximum refundable adoption credit increased to $13,360 from $13,170 for out-of-pocket expenses for the legal adoption of a child.

Self-employed Health Insurance Deduction: Self-employed health insurance deduction includes insurance premiums paid to cover a child who was under 27 years of age at the end of 2011, regardless of whether the child qualifies as a dependent. The health insurance premium is also deductible for self-employment tax purposes.

Sales Tax Deduction Continues: Deduction for state and local sales taxes in lieu of income taxes is extended for 2011.

Medical Expenses: Beginning in 2011, only prescription drugs, other than insulin, are considered qualified expenditures for Health Saving Accounts (HSA), Flexible Spending Arrangements (FSA) or Health Reimbursement Accounts (HRA). Over-the-counter drugs can no longer be paid with pre-tax dollars.

Certain deductions and exclusions from income were not extended for 2011, such as:

- Self-employed health insurance premiums are no longer deductible for self-employment taxes;
- Advance earned income tax credit; and
- Making work pay credit.

Businesses

S Corporation Built-in Gains: A C corporation that elects S corporation status is taxed at the highest corporate rate on built-in gains recognized during the recognition period, which is generally the 10-year period starting on the first day of the first year of S status. For 2011, the built-in gain tax is not imposed if at least five years of the recognition period ended before 2011.

Cancellation of Debt (COD) Income: For 2009 and 2010, COD income from business debt discharged in connection with reacquisition could be deferred (and taken into income ratably over five years, starting in 2014). This income deferral provision has expired for debt discharged after 2010.

Domestic Production Activities Deduction: Deduction percentage increases to 9 percent of qualified production activities income.

Increased First-year Expensing: Expense amount $500,000 with a phase-out amount of $2 million for the purchase of certain qualified property.

Bonus Depreciation: For property placed in service after September 8, 2010, and before the end of 2011, taxpayers can fully deduct the cost of eligible equipment the year it is placed in service. To qualify for bonus depreciation, property must generally have a useful life of 20 years or less under the modified accelerated cost recovery system (MACRS). If no new legislation is enacted, property placed in service in 2012 will qualify for regular bonus depreciation, in which 50 percent of the cost is deductible in the year it is placed in service and the rest is depreciated using normal rules.

Section 179: Businesses can expense up to $500,000 under Section 179, with phase-out beginning when property placed in service exceeds $2 million.

Cell Phones: Are no longer considered listed property subject to specially unfavorable depreciation rules.

Startup Expenses: Deduction for business startup expenses decreased from $10,000 to $5,000, with a phase-out threshold beginning at $50,000. No current deduction is available when total startup costs reach $55,000. Costs instead must be amortized over five years.

Research Credit Continues: Credit is available for expenditures related to qualified research expenses.

For Further Information

For details in connection with many of the tax changes described above, please visit our publications page located here or contact any of the practitioners in the Tax Accounting Group.