

Planning for those “Taxable Events”

Most people want answers to specific questions on tax returns or interpretations of new laws. Some already know the answer and just want verification, while others want guidance on where to look for clarification on what they are reading. We can provide just what you're looking for. We give each of our clients the commitment to providing the best and up-to-date knowledge on your returns. Our preparers spend many hours going to classes, update courses, and seminars to provide you with the best service possible.

The goal of tax planning is reduce the surprise when preparing your taxes. You want to minimize what you pay in taxes. Are you having a taxable event in your life? Would you know when to recognize a taxable event? Taxable events happen all the time in your life, let us help make the most of them! The more you prepare and plan during the tax year the better the chances you won't be caught off guard with a balance due at the end of the year. Click here to contact a tax preparer to help with your tax planning.

Our preparers will show you how to adjust your payroll withholdings to prepare for the next year's taxes. With our paystub calculation service (shown below) we can help you stay on top of your individual tax situation. You can avoid owing at the end of the year by increasing your withholding. There will be more money taken out of your paycheck throughout the year, but it will help you get a bigger refund when you file your taxes.

Not everyone is the same when it comes to preparing taxes. Everyone talks about how much money they received because they did this or that but the story might not be the same for you! If you hear something and want us to explain how it would affect you and your tax situation give us a call! Remember, we work for you not for the IRS. Many of our clients save many times the fee in reduced tax liability through careful planning and legitimate tax strategies.

Key Tax Planning Information:

1. **2009 Tax Law Changes** – I will update this closer to the end of the year.
2. **Reducing Your Income** – Your Adjusted Gross Income (AGI) is the amount used in the calculation of your income tax liability.
 - a. You start with your gross income and this includes: your wages, interest income, dividend income, income from certain retirement accounts, capital gains or losses, alimony received, rental income, royalty income, farm income, unemployment compensation, and certain other kinds of income. All of these added up becomes your **Total Income**.
 - b. You then “adjust” your income by deducting different allowable expenses such as: educator expenses, certain business expenses of reservists, performing artists, and fee-basis government officials, health savings contributions, moving expenses, one-half of self-employment tax, contributions by the self employed for SEP, SIMPLE, and other qualified plans, health insurance deductions for the self employed, penalties on early withdrawal of savings, alimony paid, IRA deductions, student loan interest deductions, tuition and fees deductions, and domestic production activities deductions. All of these deductions have specific rules or ways to qualify for the deductions. They are not always straight forward.
 - c. You subtract your adjustments to income from your Total Income and you have your Adjusted Gross Income (AGI).
3. **Increase Your Tax Deductions** - Taxable income is another key element in your overall tax situation. Taxable income is what's left over after you have reduced your AGI by your deductions and exemptions. Almost everyone can take a standard deduction, and some people are able to itemize their deductions. Your standard deduction and personal exemptions depends on your filing status and

how many dependents you have. You can increase your standard deduction and personal exemptions by getting married or having more dependents. The best strategy for reducing your taxable income is to itemize your deductions, and the three biggest deductions are mortgage interest, state taxes, and gifts to charity.

a. **Standard Deductions for 2009:**

- i. Single - \$5,700
- ii. Married Filing Jointly - \$11,400
- iii. Head of Household - \$8,350
- iv. Qualified Widower - \$11,400
- v. Married Filing Separately - \$5,700
- vi. Additional Amount if Blind - \$1,100 (For MFJ, MFS, or QW)
- vii. Additional Amount if Blind - \$1,400 (For S & HH)

b. **Personal Exemptions for 2009:**

- i. Per Taxpayer and each Dependents - \$3,650

4. **Retirement Plan Limits** - You can save for retirement up to the maximum dollar limit. Maximum contributions vary by the type of retirement plan:

- a. Traditional or Roth IRA: \$5,000 (\$6,000 if age 50 or older)
- b. SEP IRA: \$49,000
- c. SIMPLE IRA: \$11,500 (\$14,000 if age 50 or older)
- d. 401(k) plan: \$16,500 (\$22,000 if age 50 or older)
- e. 403(b) plan: \$16,500 (\$22,000 if age 50 or older)
- f. 457 plan: \$16,500 (\$22,000 if age 50 or older)
- g. Defined Contribution Pension: \$49,000
- h. Defined Benefit Pension: \$195,000
- i. If you fund both a traditional and Roth IRA, your total contribution to cannot exceed \$5,000 combined (or \$6,000 if age 50 or older).

5. **Take Advantage of Tax Credits** - These credits can increase a refund or reduce a tax bill. Usually, credits can only lower a tax liability to zero. But some credits, such as the EITC, the child tax credit, the Recovery Rebate Credit and the first-time homebuyer credit, are refundable — in other words, they can make the difference between a balance due and a refund. One of the best, and most abused, tax credit is the Earned Income Credit (EIC). Unlike other tax credits, the EIC is credited to your account as a payment. And that means the EIC often results in a tax refund even if the total tax has been reduced to zero. You may be eligible to claim the earned income credit if you earn less than a certain amount.

- a. **Credit for Child and Dependent Care Expenses** — a qualifying child must be under the age of 13 or permanently and totally disabled. A qualifying child is determined without regard to the exception for children of divorced or separated parents and the exception for kidnapped children.
- b. **Child Tax Credit** — a qualifying child must be under age 17 and a U.S. citizen or national or a U.S. resident.
- c. **Earned Income Tax Credit** — a qualifying child does not have to meet the support test. Also, a qualifying child must have lived with the taxpayer in the United States for more than half the year and have a social security number that is valid for employment in the United States. A qualifying child is determined without regard to the exception for children of divorced or separated parents. If a qualifying child is married, he or she must also meet the marital status and nationality tests for a dependent.

6. **Avoid Additional Tax** - You may also want to avoid additional taxes. If at all possible, avoid early withdrawals from an IRA or 401(k) retirement plan. The amount you withdraw will become part of your taxable income, and on top of that there will be additional taxes to pay on the early withdrawal.

7. **Dependents** – Remember that a dependent is a person other than the taxpayer who entitles the taxpayer to claim a dependency exemption. In 2009 the dependent issue has changed in a huge way. There are a few questions and additional steps that have to be answered and completed before a taxpayer can claim a dependent on their tax return.
- a. A dependent must be a US Citizen or national, or a resident of the US, Canada, or Mexico. If married, did not file a joint return for that year, unless the return is filed only as a claim for refund and no tax liability would exist for either spouse if they had filed separate returns.
 - b. **Dependent Myths BUSTED!**
 - i. **Dependents may be required to file their own tax return.** Even though you are a dependent on someone else's tax return, you may still have to file your own tax return. Whether or not you must file a return depends on several factors, including: the amount of your unearned, earned or gross income, your marital status, any special taxes you owe and any advance Earned Income Credit payments you received.
 - ii. **Exemptions reduce your taxable income.** There are two types of exemptions: personal exemptions and exemptions for dependents. For each exemption you can deduct \$3,500 on your 2008 tax return. Exemptions amounts are reduced for taxpayers whose adjusted gross income is above certain levels, which is determined by your filing status.
 - iii. **Dependents may not claim an exemption.** If you claim someone as a dependent, such as your child, that dependent may not claim a personal exemption on their own tax return.
 - iv. **Your spouse is never considered your dependent.** On a joint return, you may claim one exemption for yourself and one for your spouse. If you're filing a separate return, you may claim the exemption for your spouse only if they had no gross income, are not filing a joint return and were not the dependent of another taxpayer.
 - v. **Some people cannot be claimed as your dependent.** Generally, you may not claim a married person as a dependent if they file a joint return with their spouse. Also, to claim someone as a dependent, that person must be a U.S. citizen, U.S. resident alien, U.S. national or resident of Canada or Mexico for some part of the year. There is an exception to this rule for certain adopted children.
 - vi. **Relatives not living with Taxpayer.** Qualifying relatives who are related in one of these ways need not live with the taxpayer. As long as you meet the other four tests (gross income, support, citizenship, joint return), you can claim these qualifying relatives as a dependent.
 - vii. **Relationships established by marriage do not end with death or divorce.** So if you support your mother-in-law, you can claim her as a dependent even if you and your spouse are divorced.
 - viii. **State Laws.** The relationship, however, must not violate local law. For example, if your state prohibits co-habitation with a married person, then you cannot claim that person as your dependent even if you meet the other criteria for claiming a dependent.
 - c. Is the dependent and Qualifying Child or a Qualifying Relative?
 1. **Qualifying Child** - A "qualifying child" may enable a taxpayer to claim several tax benefits, such as head of household filing status, the exemption for a dependent, the child tax credit, the child and dependent care credit and the earned income tax credit. To be a Taxpayer's Qualifying Child, a person must satisfy four tests:
 - a. **Relationship** — the taxpayer's child or stepchild (whether by blood or adoption), foster child, sibling or stepsibling, or a descendant of one of these.

- b. **Residence** — has the same principal residence as the taxpayer for more than half the tax year (6 months + 1 day). *Exceptions apply, in certain cases, for children of divorced or separated parents, kidnapped children, temporary absences, and for children who were born or died during the year.
 - c. **Age** — must be under the age of 19 at the end of the tax year, or under the age of 24 if a full-time student for at least five months of the year, or be permanently and totally disabled at any time during the year.
 - d. **Support** — did not provide more than one-half of his/her own support for the year.
 - e. **Tie-Breaker** — If a child is claimed as a qualifying child by two or more taxpayers in a given year, the child will be the qualifying child of: the parent; if more than one taxpayer is the child's parent, the one with whom the child lived for the longest time during the year, or, if the time was equal, the parent with the highest AGI; if no taxpayer is the child's parent, the taxpayer with the highest adjusted gross income (AGI).
 - f. ***Exceptions** — The non-custodial parent can claim a dependent if they have a signed Form 8332, Release to Claim to Exemption for Child of Divorced or Separated Parents from the custodial parent. If a divorce decree or separation agreements state that one parent can claim the child for whatever reason then the Form 8332 must be signed and match the decree or agreements. If the custodial parent will not sign the Form 8332 for the non-custodial parent then the only way the non-custodial parent can claim the child is to take the custodial parent to court to and get a judge to require the Form 8332 to be filled out to match the decree or agreement. As of January 1, 2009 the IRS will NO LONGER take divorce decrees or separation agreements to prove dependency.
2. **Qualifying Relative** — to be a qualifying relative the person must meet ALL of the tests:
- a. The person cannot be your qualifying child or the qualifying child of anyone else.
 - b. The dependent will meet the relationship test for being claimed as a qualifying relative if the dependent is related to the taxpayer in one of the following ways: son or daughter, grandson or granddaughter, great grandson or great granddaughter, stepson or stepdaughter, or adopted child, brother or sister, half-brother or half-sister, step-brother or step-sister, mother or father, grandparent, great-grandparent, stepmother or stepfather, nephew or niece, aunt or uncle, son-in-law, daughter-in-law, brother-in-law, sister-in-law, father-in-law, or mother-in-law, or foster child who was placed in your custody by court order or by an authorized government agency. You may be able to claim cousins, friends, boyfriend or girlfriend, or domestic partner as a dependent if they live with you the entire year and they meet the other criteria including not violating state or local law.
 - c. The person's gross income for the year must be less than \$3,500.
 - d. You must provide more than half of the person's total support for the year.

Paystub Calculations-

We would be happy to review your paychecks to verify that enough tax money is being withheld from them. We can estimate what your 2009 refund or balance due will be and help you adjust your withholdings. This is a great tax planning tool for people who want to control their refunds or have more money in their pockets during the year. For some this is a savings account that pays out during tax season, to others they would rather not give an interest free loan to the government...Who are you?

What do we need? The most recent paystub for yourself (and your spouse). We will also need any final paystubs from jobs that ended in 2009. If you have taken any money from a retirement account we will need to know how much and the circumstances behind it. We can even help you with the tax planning if you contact us before taking any money from your retirement accounts. We will also need any other income you have earned during the year (example: business income, unemployment income, interest, dividends, stock sales, etc.)

We will review your deductions from 2008 and work with you to figure out what you will have in 2009.

Don't be surprised for your refund or the balance you will owe when tax season rolls around! Take the steps to good tax planning today!

Avoiding Tax Traps in a Divorce

Over the past several years, numerous changes have been made to the tax treatment of dependents, alimony, child support, property settlements, and other divorce related issues which can produce unintended results for divorced individuals. Failure to understand these rules can be very costly.

Child Dependency Exemption

The custodial parent is entitled to the exemption for the dependent child for any divorce or separation parents.

There are certain exceptions which allow the non-custodial spouse to claim the exemption for the child:

1. The custodial parent releases the exemption of the child(ren) to the non-custodial spouse through the use of IRS Form 8332. In lieu of Form 8332, the IRS will accept a copy of the cover page of the agreement (with the custodial parent's social security number added), the specific clause unconditionally stipulating the exemption to the non-custodial parent, and the signature page showing the date of the agreement.
2. There is a pre-1985 divorce agreement, whereby a completely different set of rules and regulations are in effect.

Alimony

Payments of alimony made under a decree of divorce or separation are deductible by the payor spouse and taxable to the payee spouse. In order to qualify as alimony, the payment must be in cash and cannot be a transfer of property or assets. There must also be a requirement that these payments will cease upon the death of the payee. This need not be stipulated in the agreement if state law requires that payments cease after the death of the payee spouse. If the individuals are either divorced or separated, they must not be living together when the cash payments are made.

Single payments of cash may qualify as alimony if the amount is \$15,000 or less. Payments exceeding \$15,000 per year are subject to a recapture rule if they do not continue for 3 years or more unless ended because of the death of either spouse or the remarriage of the payee.

Any cash payments made to a third party, if required by the agreement on behalf of the payee spouse, will still qualify as alimony payments. Thus, payments made for rent, mortgage, tuition, or living expenses of the payee spouse under the terms of the divorce or separation instrument can qualify as alimony payments.

The agreement may also call for property settlement payments to be made from pension or retirement funds under a Qualified Domestic Relations Order (QDRO). Transfers made under a QDRO are exempt from the 10% penalty on premature distributions from qualified retirement plans.

Disposition of Principal Residence

What happens to a jointly-owned principal residence is usually a key item in a divorce agreement. The three most frequent provisions chosen are (1) sell the house and divide the proceeds with each spouse reporting his or her share of the sale on separate returns; (2) transfer the house to one spouse or the other; (3) retain joint ownership allowing the custodial parent to reside therein but delay the sale of the house until the occurrence of a specific event (remarriage of the custodial parent, children reaching specific ages, etc.).

Child Support

Under both prior and current law, child support is neither taxable to the recipient nor deductible by the payor. Prior to 1985, alimony and child support were sometimes required as one payment known as "family support." This was taxed or deducted as alimony in spite of the fact that the decree made it clear that a portion of it was for child support. Under current law, if part of an alimony payment is based on a child's situation (such as coming of age, marriage, college), that portion of the payment is presumed to be child support and is not deductible or taxable. Pre-1985 decrees have not been affected by this change.

IRA Deduction

Alimony payments received by a payee are considered to be "earned income" for the purpose of allowing alimony recipients to contribute to an Individual Retirement Account. This is true even if the alimony recipient is not employed and, therefore, not earning wages.

Deductibility of Legal Fees

Legal fees paid in connection with obtaining a divorce are not deductible. Fees paid for obtaining and/or maintaining alimony or income producing property and for tax advice are deductible. In order to qualify as deductible legal fees, the attorney must stipulate, on the bill, the amount or percentage of the fee which is attributable to tax matters. Legal fees are miscellaneous itemized deductions subject to the 2% of AGI limitation.

Innocent Spouse Provisions

The IRS Restructuring and Reform Act of 1998 made the benefits of Innocent Spouse status easier to obtain. The Act expands the benefits to all understatements of tax attributable to erroneous items of the other spouse, regardless of the dollar amount.

The Act offers three types of potential relief based on factors such as how much the innocent spouse is aware of the understatement, for taxpayers no longer married to or legally separated from the person with whom they originally filed a joint return, and for taxpayers for whom the IRS may grant equitable relief. Consult with your tax professional for details.

Community Property States

If you live in a Community Property State (AZ, CA, ID, LA, NV, NM, TX, WA, or WI), the tax rules for filing the tax return for the year of the divorce or legal separation are different from the instructions in the tax booklet you receive from the IRS. These special rules may also apply to any returns filed Married Filing Separate prior to the divorce or legal separation.