

January 2011

## COST-OF-LIVING ADJUSTMENTS AND NEW LEGISLATION SHAPE 2011 TAX PLANNING

In the fall, the IRS started releasing various rates, limits and other inflation-indexed amounts for 2011. But it waited to release other amounts until the fates of various expiring tax provisions were settled. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, signed into law Dec. 17, extended most expiring provisions, and the IRS has now released most inflation-adjusted amounts for 2011.

Some of the amounts will increase a little in 2011, which could affect your tax planning. But many amounts will stay the same as they were in 2010.

### **INDIVIDUAL INCOME TAXES**

Tax brackets will widen and personal exemptions will increase for 2011. Tax-bracket thresholds are set to increase for each filing status but more significantly for the higher brackets. For example, the top of the 10% bracket increases by \$125 to \$250, depending on filing status, for 2011, but the top of the 33% bracket increases by \$5,500 (\$2,750 for married filing separately). This should reduce the risk of slightly higher earnings in 2011 pushing taxpayers into a higher tax bracket.

The personal and dependency exemption increases by only \$50, to \$3,700, for 2011. The good news for higher-income taxpayers, though, is that the income-based personal exemption phaseout and the itemized deduction phaseout, which were eliminated for 2010, are also eliminated for 2011 under the Tax Relief act.

2011 ordinary income tax brackets				
Tax rate	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	\$0-\$8,500	\$0 - \$12,150	\$0 - \$17,000	\$0 - \$8,500
15%	\$8,501-\$34,500	\$12,151-\$46,250	\$17,001-\$69,000	\$8,501-\$34,500
25%	\$34,501-\$83,600	\$46,251-\$119,400	\$69,001-\$139,500	\$34,501-\$69,675
28%	\$83,601-\$174,400	\$119,401-\$193,350	\$139,501-\$212,300	\$69,676-\$106,150
33%	\$174,401-\$379,150	\$193,351-\$379,150	\$212,301-\$379,150	\$106,151-\$189,575
35%	Over \$379,150	Over \$379,150	Over \$379,150	Over \$189,575

### **EDUCATION- AND CHILD-RELATED BREAKS**

Many education- and child-related tax breaks were set to become less beneficial starting in 2011, but the Tax Relief act extended the favorable provisions, generally through 2012. Most education- and child-related tax breaks are limited based on the taxpayer's modified adjusted gross income (MAGI), and the MAGI phaseout ranges remain the same or increase moderately for 2011, depending on the break. Taxpayers whose MAGIs are within the applicable phaseout range are eligible for a partial break; breaks are eliminated for those whose MAGIs exceed the top of the range.

For example, the MAGI phaseout ranges for the American Opportunity education credit remain the same for 2011: \$160,000–\$180,000 for married couples filing jointly, and \$80,000–\$90,000 for other filers. (Bear in mind that, if you’re married filing separately, you aren’t eligible for the education credits.)

The MAGI phaseout range limits for the Lifetime Learning credit, however, increase for 2011; they’re \$102,000–\$122,000 for joint filers, and \$51,000–\$61,000 for other filers (compared to \$100,000–\$120,000 and \$50,000–\$60,000, respectively, for 2010). If your MAGI is too high for you to qualify for these credits, your children may nonetheless qualify.

The MAGI phaseout range limits for the adoption credit also increase, to \$185,210–\$225,210 for 2011, from \$182,520–\$222,520 for 2010. The maximum adoption credit increases from \$13,170 to \$13,360.

Check with your tax advisor for information on other education- and child-related breaks of interest to you.

### **RETIREMENT PLANS**

Retirement-plan-related limits will generally remain the same or undergo only small changes for 2011. All of the limits below are the same as those that applied in 2010.

<b>Type of limitation</b>	<b>2011 limit</b>
Elective deferrals to 401(k), 403(b), 457(b)(2), and 457(c)(1) plans	\$16,500
Annual benefit for defined benefit plans	\$195,000
Contributions to defined contribution plans	\$49,000
Contributions to SIMPLEs	\$11,500
Contributions to IRAs	\$5,000
Catch-up contributions to 401(k), 403(b), 457(b)(2), and 457(c)(1) plans	\$5,500
Catch-up contributions to SIMPLEs	\$2,500
Catch-up contributions to IRAs	\$1,000
Compensation for benefit purposes for qualified plans and SEPs	\$245,000
Compensation for SEP coverage	\$550
Highly compensated employee threshold	\$110,000
Social Security taxable wage base	\$106,800

MAGI phaseout ranges apply to the deductibility of contributions to traditional IRAs if the taxpayer (or his or her spouse) participates in an employer-sponsored retirement plan. Taxpayers with MAGIs within the applicable range can deduct a partial contribution; those with MAGIs exceeding the top of the range can take no deduction.

For married taxpayers filing jointly, the phaseout range is specific to each spouse based on whether he or she is a participant in an employer-sponsored plan. For the spouse who participates, the phaseout range for 2011 is \$90,000–\$110,000, up from \$89,000–\$109,000. For the spouse who doesn’t participate, the phaseout range limits increase by \$2,000, to \$171,000–\$181,000. For single and head-of-household taxpayers participating in an employer-sponsored plan, the phaseout range remains the same: \$56,000–\$66,000.

If you (or your spouse) participate in an employer-sponsored plan and your income exceeds the applicable MAGI limit, you can make nondeductible IRA contributions up to the applicable IRA contribution limit (reduced by any Roth IRA contributions you make).

You can contribute to a Roth IRA regardless of whether you participate in an employer-sponsored plan, but MAGI limits do apply. You can make a partial contribution if your MAGI falls within the applicable range, but no contribution if it exceeds the top of the range. For married taxpayers filing jointly, the 2011 phaseout range limits increase by \$2,000, to \$169,000–\$179,000. The phaseout range limits also increase by \$2,000 for single and head-of-household taxpayers, to \$107,000–\$122,000.

### **GIFT AND ESTATE TAXES**

The annual gift tax exclusion will remain at \$13,000 for 2011.

The gift, estate and generation-skipping transfer (GST) taxes had been scheduled to return to pre-2001 law levels in 2011, with a \$1 million exemption and 55% tax rate. As a result of the Tax Relief act, however, the top gift and estate tax rates and the GST tax rate will be 35% for 2011, and the 2011 exemptions for the gift, estate and GST tax will be \$5 million.

The estate tax exemption available at death continues to be reduced by any gift tax exemption used during life. But another Tax Relief act provision enhances the estate tax exemption for 2011: If one spouse dies and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. (The provision doesn't allow the deceased spouse's remaining GST tax exemption to be used by the surviving spouse.)

### ***PLAN NOW TO MINIMIZE YOUR TAXES***

With the release of the inflation-adjusted amounts and the extension and expansion of various tax breaks under the Tax Relief act, smart and timely tax planning is critical. While we've focused on 2011 amounts here, keep in mind that many breaks are good only through 2012, and others only through 2011 — and some amounts may change significantly in future years.

It's never too early to start planning how you can minimize your income taxes for 2011 — and beyond.

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