Rule changes, tax break details can trip you up

By Lynn Asinof

Globe Correspondent / **March 20, 2011**

With just under a month to go before the filing deadline, taxpayers who haven't started on their taxes yet may have some surprises in store.

The flurry of legislation at the end of last year extended some tax breaks, but let others expire. Moreover, filers who plan to take advantage of some popular 2010 tax breaks such as the home buyer and energy tax credits can get tripped up by the rules. Still others may find that their debt-reduction efforts last year will actually boost their tax bill, since forgiven debt on credit cards is taxable as income.

"You have to pay attention to the details,'' said fee-only financial planner and tax preparer Dana Levit of Paragon Financial Advisors in Newton. This year, she says, people will find lots of small rule changes as well as some disappearing opportunities.

Among those tax breaks no longer available are several that were created to help people weather the recession. Filers who received unemployment benefits in 2010, for example, will find those benefits are now fully taxable. "For 2009, the first $2,400 was tax free, and that isn't the case this year,'' said Jeff Pirner, district manager with H&R Block, Boston.

And unlike the 2009 tax returns, people who take the standard deduction for 2010 — generally $5,700 for single filers and $11,400 for those married filing jointly — will no longer be able to deduct property taxes.

Pirner said many of the questions he is getting from taxpayers reflect recent and ongoing problems in the economy. For example, many filers were surprised to receive 1099-C forms from their credit card companies for the income attributable to debt forgiveness. That money is taxable, Pirner says, and failure to pay can lead to an IRS bill that includes penalties and interest.

Those laid off as the economy faltered may have turned to consulting last year. Income from such work is taxable and typically reported on 1099 forms. Here, however, business expenses such as office supplies, travel expenses, and Internet fees can be deducted on Schedule C of the return to reduce the tax bite. "This is why it is really important to keep track of your expenses,'' Pirner says.

Levit says one of the most common questions from her clients concerns the energy credit, which provides a 30 percent credit to a maximum of $1,500 on qualified home improvements, such as storm doors, windows, and insulation. If you maxed out on this credit in 2009, you can't claim it in 2010, says Levit. But if you only claimed part of the credit — let's say $1,200 for installation of $4,000 worth of energy-efficient windows — you still have $300 of the credit that can be used this year.

Folks who purchased a primary residence between 2008 and 2010 may find themselves wrestling with the first-time home buyer credit. Those who took this tax break for the 2008 tax year must now begin repaying it. The credit, which was designed as a tax-free loan of up to $7,500, is to be repaid in 15 equal annual installments beginning with the filing of the 2010 taxes.

In 2009, Congress made the credit a straight tax break. Repayment is not necessary as long as the taxpayer doesn't sell or change principal residence for three years.

Those who purchased their principal residence in 2010 may also qualify for the home buyer credit — now worth up to $8,000 for qualified first-time home buyers and up to $6,500 for longtime homeowners — if they had a contract by April 30, 2010, and closed before Oct. 1, 2010.

People filing for the credit on their 2010 return are required to provide a copy of the contract and the settlement statement. Longtime homeowners also must provide documentation such as property tax records to prove five consecutive years of residency.

Last year, nearly 100 million taxpayers took advantage of e-filing. The IRS is encouraging the practice, offering tax software from more than a dozen companies to filers with an adjusted gross income of $58,000 or less. Regardless of income, all taxpayers have access to the IRS's Fillable Forms, an electronic version of the traditional paper forms. Information about both options is available at www.IRS.gov.

Checking on the status of a refund check can also be done digitally, either through the Internal Revenue Service's website or with a new smartphone app called IRS2Go, available free to both Apple and Android users.

Taxpayers get an extra three days to file this year. With Washington's Emancipation Day observed on April 15, the federal deadline has been pushed to April 18. In Massachusetts, that's
Patriots
Day, so the state return isn't due until April 19.

Finally, last year's extension of Bush era tax cuts means taxpayers have a two-year planning window before rate increases are back on the table. Taxpayers may want to consider converting some of their traditional individual retirement account assets to Roth IRAs to take advantage of current low income-tax rates. A Roth conversion is a taxable event because traditional IRAs are funded with pretax dollars, with withdrawals taxed as ordinary income. Roths, however, are funded with afer-tax dollars, and qualified withdrawals are not taxed.

Rate expectations are also a factor in deciding when to pay taxes on conversions done in 2010. The entire bill can be paid with 2010 taxes, or people can wait, and split the taxable income between their 2011 and 2012 returns.

Likewise, those with large capital gains in their portfolios may want to develop a strategy to lock in advantageous capital gains rates before they expire in 2012.