



January 2011

As we forge ahead into a new year, it is important for taxpayers to have an understanding of tax rates and limitations for 2011. A number of valuable but temporary individual tax incentives scheduled to expire after December 31, 2010 were extended by the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010* (Tax Relief Act). If Congress had not acted, reductions in the individual tax rates, the \$1,000 child tax credit, and other enhanced tax incentives would have expired after 2010. Many of these incentives were originally enacted in the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTTRA) and further enhanced in subsequent tax legislation.

This letter is intended as a quick reference guide to limitations and rates that are in effect for the 2011 tax year, including those affected by the *Tax Relief Act*.

FEDERAL LIMITATIONS AND RATES FOR 2011

Education Savings Options:

- **Coverdell Education Savings Account (ESA) Limit:** Taxpayers may contribute up to \$2,000 annually to a tax-exempt Coverdell Education Savings Account for an individual under age 18. An ESA may be used for qualified education expenses, including elementary, secondary, and post-secondary school expenses. For contributors who are individuals, the maximum contribution is reduced ratably for modified adjusted gross income (AGI) between \$190,000 and \$220,000 for joint filers, and between \$95,000 and \$110,000 for others.
- **American Opportunity Tax Credit (formerly Hope Scholarship Credit):** Through 2012, the American Opportunity Tax Credit will be 100% of up to \$2,000 of qualified tuition and related expenses plus 25% of those expenses between \$2,000 and \$4,000, for a total maximum credit of \$2,500 per eligible student. The credit is 40 percent refundable and can be claimed only the first four years of postsecondary education. It is also only available for the pursuit of a degree or credential and requires at least half-time enrollment. The credit phases out ratably for taxpayers with modified AGI of \$80,000 to \$90,000 (\$160,000 to \$180,000 for a joint return).
- **Lifetime Learning Tax Credit:** The Lifetime Learning Credit for 2011 remains at \$2,000 per family for every additional year of college or graduate school. The credit continues to be phased out at modified AGI between \$50,000 and \$60,000 (\$100,000 and \$120,000 for joint filers). The Lifetime Learning Credit is calculated on a per family (per tax return) basis, whereas the American Opportunity Tax Credit is calculated on a per student basis. Also different from the AOTC, the Lifetime Learning Credit is not refundable, is available for any year of postsecondary education, is not limited to the pursuit of a degree or credential, and does not require half-time enrollment.

Collectively, the American Opportunity Tax Credit and the Lifetime Learning Tax Credit are referred to as the “Higher Education Credit”. Both credits may not be claimed for the same student in the same tax year.

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- **Higher Education Tuition Deduction:** In 2011, a \$4,000 above-the-line higher education tuition deduction is available to single individuals with AGI of \$65,000 or less and to joint filers with AGI of \$130,000 or less. A reduced deduction of \$2,000 is available to single individuals with AGI of \$80,000 or less and joint filers with AGI of \$160,000 or less. The amount of qualified tuition and related expenses for the higher education tuition deduction must be reduced for any exclusion from gross income for a Coverdell ESA and income from savings bonds used to pay higher education tuition and fees. Taxpayers may not claim the deduction for qualified tuition and related expenses and an American Opportunity Tax Credit or Lifetime Learning Credit for the same student in the same year.
- **Student Loan Interest:** You may be eligible for an above-the-line deduction for student loan interest paid on any “qualified education loan.” The maximum deduction is \$2,500. The deduction through 2012 is phased out at a modified AGI level between \$120,000 and \$150,000 for joint filers, and between \$60,000 and \$75,000 for individual taxpayers.
- **Interest Exclusion for Higher Education:** The interest on U.S. savings bonds redeemed to pay qualified higher education expenses may be tax-free. The phase-out for 2011 will begin at modified AGI above \$71,100 (\$106,650 on a joint return). For 2010, the corresponding figures are \$70,100 and \$105,100. This applies to Series EE and I bonds issued after 1989.
- **Above-the-line Deduction for Elementary and Secondary School Teachers:** For 2011, teachers and other school professionals can take a \$250 above-the-line deduction for expenses incurred for books, supplies, computer equipment, other equipment, and supplementary materials used in the classroom.

Retirement Savings Plans:

- **Defined Pension Plan Benefits:** The limitation on the annual benefit under a defined benefit plan is \$195,000 for 2011.
- **Elective Deferrals:** The limit on the exclusion for elective deferrals (which applies to 401(k) plans, 403(b) annuities, and salary reduction SEPs) remains at \$16,500 for 2011. Catch-up contributions for individuals aged 50 or over remains unchanged at \$5,500 (except for 401(k)(11) plans and SIMPLE plans, for which the limit is \$2,500).
- **IRA Contribution Limit:** The annual combined limit for contributions to traditional and Roth IRAs remains unchanged at \$5,000 for 2011, with a \$1,000 catch-up contribution maximum for taxpayers aged 50 and older.

The allowable deductible contribution of a traditional IRA will be phased-out for 2011 for MAGI starting at:

- Married filing jointly: \$90,000 (if the taxpayer is covered by a retirement plan at work);
- Married taxpayer filing jointly who is not covered by a retirement plan at work but whose spouse is: \$169,000;
- Married filing separate: \$10,000 (if the taxpayer is covered by a retirement plan at work). If married filing separate and the taxpayer did not live with his/her spouse at any time during the year, the IRA deduction is determined the same as if the taxpayer was “single”; and
- Single and head of household: \$56,000 (if the taxpayer is covered by a retirement plan at work).

The maximum annual contribution that can be made to a Roth IRA is phased-out for 2011 for MAGI starting at:

- Married filing jointly: \$169,000;
 - Single, head of household, and married filing separately (if the taxpayer did not live with his/her spouse at any time during the year): \$107,000; and
 - Married filing separately (if the taxpayer lived with his/her spouse at any time during the year): \$10,000.
- **Retirement Plan Contribution Limit:** The maximum amount that can be contributed to a participant's defined contribution account(s) by the employer and the employee combined remains at \$49,000 in 2011. The maximum compensation limit for the calculation of employer contributions to qualified plans also remains unchanged at \$245,000.
 - **SEP Contribution Limit:** The annual limit on the amount an employer can contribute to a Simplified Employee Pension (SEP) for 2011 is the lesser of 25% of compensation or \$49,000.
 - **SIMPLE Deferrals:** The maximum amount of compensation an employee may elect to defer for a SIMPLE plan remains at \$11,500 for 2011. Catch-up contributions for individuals aged 50 or over remain at \$2,500.

Other Key Limitations and Rates:

Federal Income Tax Rates and Limits

- **Individual Tax Rates:** The *Tax Relief Act* extends through December 31, 2012, the individual marginal income tax rates of 10, 15, 28, 33, and 35 percent. If Congress had not acted, the rates would have reverted to 15, 25, 28, 36, and 39.6 percent in 2011.
- **AMT Relief for 2011:** In recent years, Congress has tried to insulate middle-income taxpayers from the alternative minimum tax (AMT) by providing higher exemption amounts and other targeted relief. The *Tax Relief Act* raises the exemption amounts for 2011 to \$48,450 for individuals, \$74,450 for married taxpayers filing jointly, and \$37,225 for married taxpayers filing separately.
- **Capital Gains and Dividends:** In 2011, individuals in the 10 and 15 percent rate brackets can take advantage of a zero percent capital gains and dividend tax rate. Individuals in higher rate brackets will enjoy a maximum tax rate of 15 percent on capital gains, as opposed to a 20 percent rate that had been scheduled to replace it and with dividends taxed at income tax rates. Only net capital gains and qualified dividends are eligible for this special tax treatment.
- **Kiddie Tax:** For 2011, the kiddie tax applies to: (1) children under 18; (2) 18-year old children who have unearned income in excess of the \$1,900, do not file a joint return and who have earned income, if any, that does not exceed one-half of the amount of the child's support; and (3) children between the ages of 19 and 23 and if, in addition to the above rules, they are full-time students. A parent will be able to elect to include a child's income on the parent's return for 2011 if the child's income is more than \$950 and less than \$9,500.

Payroll Tax Rates and Limits

- **Payroll Tax Cut:** Effective for calendar year 2011, the employee share of the OASDI portion of Social Security taxes is reduced from 6.2 percent to 4.2 percent up to the taxable wage base of \$106,800. Self-employed individuals also benefit. Self-employed individuals will pay 10.4 percent on self-employment income up to the wage base (reduced from the normal 12.4 percent rate). The payroll cut replaces the *Making Work Pay* credit, which reduced income tax withholding for wage earners in 2009 and 2010. The payroll tax cut, unlike the credit, does not exclude some individuals based on their earnings and has the potential of significantly higher benefits (with a maximum payroll tax reduction of \$2,136 on wages at or above the \$106,800 level as compared to a maximum available \$800 Making Work Pay credit for married couples filing jointly (\$400 for single individuals)).
- **Social Security Wage Base:** The 2011 wage base will remain unchanged at \$106,800.

Estate and Gift

- **Gift Tax Annual Exclusion:** The annual gift tax exclusion for federal and Tennessee (Class A donees) tax purposes remains at \$13,000 for 2011. The Tennessee exclusion amount remains at \$3,000 for Class B donees for 2011. Class A donees include husbands, wives, sons, daughters, lineal ancestors, lineal descendants, brothers, sisters, sons-in-law, daughters-in-law, or stepchildren. If a person has no children or grandchildren, a niece or nephew will be considered a Class A donee. Class B donees consist of all other recipients.
- **Estate Tax:** The *Tax Relief Act* revives the estate tax, but with a maximum estate tax rate of 35 percent with a \$5 million exclusion. The revived estate tax is in place for decedents dying in 2011 and 2012. The new law gives estates the option to elect to apply the estate tax at the 35 percent/\$5 million levels for 2010 or to apply carryover basis for 2010. The new law also allows “portability” between spouses of the maximum exclusion and extends some other taxpayer-friendly provisions originally enacted in 2001.

Individual Deductions and Credits

- **Child Tax Credit:** A taxpayer may claim a tax credit for each child who is under age 17 at the close of the year and satisfies relationship, residency, support, citizenship, and dependent tests. The child tax credit is \$1,000 per qualifying child for 2011. The credit continues to be phased-out for taxpayers with adjusted gross income (AGI) starting at \$110,000 for joint filers and \$75,000 for other taxpayers.
- **Dependent Care Credit:** The dependent care credit applies to expenses for the care of a qualifying individual that enable the taxpayer to work. The credit is a percentage of employment-related expenses, limited by a taxpayer’s AGI. Previous legislation increased the maximum amount of eligible expenses from \$2,400 to \$3,000 for one qualifying individual and from \$4,800 to \$6,000 for two or more qualifying individuals. The maximum credit increased from 30 to 35 percent; the credit could be reduced to a minimum of 20 percent for AGI above \$15,000. Under the *Tax Relief Act*, the enhanced dependent care credit is extended for two years, through December 31, 2012.

- **Energy Incentives:** In 2011, individuals who make energy efficiency improvements to their residences can take advantage of a tax credit equal to 10 percent of the sum of expenditures for qualified energy efficiency improvements and property, such as furnaces, water heaters, insulation materials, exterior windows and doors, and other items. Whereas a credit of up to \$1,500 was available for 2009 and 2010 improvements, the maximum credit for 2011 improvements is only \$500. If a credit was taken in a prior year, no further credit is available.
- **Health Savings Accounts:** For calendar year 2011, the limitation on deductions for an individual with self-only coverage under a high deductible health plan is \$3,050. For an individual with family coverage under a high deductible health plan, the limitation is \$6,150. Catch-up contributions for individuals aged 55 or over who are not yet eligible for and enrolled in Medicare remain at \$1,000.
- **Standard Deduction and Personal Exemption:** The standard deduction will increase to \$11,600 in 2011 for joint filers and surviving spouses, and \$5,800 for single and separate filers. The amount for head of household filers increases to \$8,500, and the personal exemption will also rise to \$3,700.
 - **Standard Deduction for Married Couples Filing Jointly:** Prior to EGTRRA, the standard deduction for a married couple filing jointly was 1.6 times the standard deduction for an unmarried individual. This is commonly called the “marriage penalty,” which was relieved under EGTRRA by increasing the standard deduction for a married couple filing a joint return to twice the single taxpayer’s amount. The *Tax Relief Act* extends the increased standard deduction for married taxpayers through December 31, 2012.
 - **Personal Exemption Phase-out:** The personal exemption phase-out reduces or eliminates the deduction for personal exemptions for taxpayers with income over certain thresholds. The total amount that may be claimed by a taxpayer is reduced by 2 percent for each \$2,500 or portion thereof that the taxpayer’s AGI exceeds a specified threshold. Beginning in 2006, the personal exemption phase-out was gradually reduced and then entirely repealed for 2010. The *Tax Relief Act* extends repeal of the personal exemption phase-out through December 31, 2012.
- **Itemized Deduction Phase-out:** The limit on itemized deductions reduces a higher-income taxpayer’s otherwise allowable itemized deductions. Certain items, however, such as medical expenses, investment interest, and casualty, theft, or wagering losses, are not limited. Beginning in 2006, the limits on itemized deductions were phased out and then entirely repealed for 2010. The *Tax Relief Act* extends complete repeal of the limit on itemized deductions through December 31, 2012.

Business Deductions and Credits

- **Bonus Depreciation:** Businesses can use bonus depreciation to immediately write off a percentage of the cost of depreciable property. The *Tax Relief Act* makes 100 percent bonus depreciation available for qualified investments made after September 8, 2010 and before January 1, 2012. It also continues bonus depreciation, albeit at 50 percent, on property placed in service after December 31, 2011 and before January 1, 2013. There are special rules for certain longer-lived and transportation property. Additionally, certain taxpayers may claim some AMT credits in lieu of bonus depreciation.
- **Section 179 Expensing:** The amount that may be expensed under Code Section 179 in 2011 is \$500,000. The expensing limit will be reduced when more than \$2 million of eligible property is placed in service. Taxpayers may expense qualified leasehold investment property, qualified restaurant property, and qualified retail improvement property. However, the maximum deduction with respect to real property is limited to \$250,000.

- **Simplified Per Diem Business Rates:** The IRS has issued “high-low” simplified per-diem rates for post-September 30, 2010 travel. Under the optional high-low method for post-September 30, 2010 travel, the high-cost-area per diem is \$233 (previously \$258), consisting of \$168 for lodging and \$65 for meals and entertainment. The per-diem for all other localities is \$160 (previously \$163), consisting of \$108 for lodging and \$52 for meals and entertainment.
- **Business Standard Mileage Rate:** The optional mileage allowance for owned or leased autos increased from 50 cents to 51 cents per mile for business travel after December 31, 2010. The rate for medical travel and qualified moving travel is 19 cents per mile for 2011. The charitable mileage rate remains at 14 cents per mile and is a statutory rate that is not adjusted for inflation.

Although not a rate or limit, the Consumer Price Index (CPI) provides a good measure of the average change in prices over a period of time for a representative basket of goods and services and may be useful in a variety of personal and business decisions. December 2010 data shows that the CPI-U increased 1.1% from November 2009 to November 2010.

Please contact us as soon as possible if we can be of assistance. Please visit our website at www.burkhartcpa.com for a complete listing of services.

We wish you and your family a blessed and prosperous new year.

Burkhart & Company, P.C.

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