1040 Quickfinder® Handbook (2010 Tax Year)

Page Updates for the 2010 Tax Relief Act

Instructions: This packet contains “marked up” changes to the pages in the *1040 Quickfinder® Handbook* that were affected by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act), which was enacted after the handbook was published. To update your handbook, you can make the same changes in your handbook or print the revised page and paste over the original page.

Note: The pages included in this packet are “marked up” for the items described in the *2010 Tax Relief Act—Handbook Update Guide* following this cover sheet.

1040 Quickfinder® Handbook
2010 Tax Year

2010 Tax Relief Act—Handbook Update Guide

How to use this guide: This guide lists the topics discussed in the 2010 *Handbook* that were affected by the 2010 Tax Relief Act, which was enacted after the *Handbook's* publication date. The changes listed here have been made for you by the Quickfinder editorial team in the Page Updates for the 2010 Tax Relief Act packet. To update your *Handbook*, you can make the same changes in your *Handbook* or print the revised page from the Page Updates for the 2010 Tax Relief Act packet and paste over the original page. For a complete summary of the 2010 Tax Relief Act (including provisions affecting 2011 and later years) go to the *Tax Act—2010 Tax Relief Act* section of the Updates section of *Quickfinder.com*.

Page	***Section or Table Title***	***Change/Comment***
Front Cover	Social Security Highlights	For 2011, the Social Security tax rate is 4.2% for employees and 10.4% for self-employed individuals.
Front Cover	2010 AGI Phase-Out Amounts/Ranges	Deduction for tuition and fees is extended to 2010 and 2011.
3-1	Quick Facts Data Sheet	Additional 2010 and 2011 amounts are now available. See the updated *Quick Facts Data Sheet* under *1040 Quickfinder® Handbook (2010 Tax Year)* in the Updates section of *Quickfinder.com*.
3-13	State and Local General Sales Tax Deduction Worksheet	Election to deduct state and local general sales taxes (in lieu of state and local income taxes) is extended to 2010 and 2011. See the *State and Local Sales Tax Deduction Worksheet (2010)* under *1040 Quickfinder® Handbook (2010 Tax Year)* in the Updates section of *Quickfinder.com*.
4-14	Qualified Charitable Distribution (QCD)	Qualified charitable distributions (QCDs) are allowed for 2010 and 2011. **Note:** Taxpayers can elect to treat QCDs made in January 2011 as occurring on December 31, 2010.
4-18	Tuition and Fees Deduction	Deduction for tuition and fees is extended to 2010 and 2011.
4-19	Additional Standard Deduction—Losses From Federally Declared Disasters	The increase to the standard deduction for losses from federally declared disasters was *not* extended to disasters occurring in 2010.
4-19	Additional Standard Deduction—Real Property Taxes	The increase to the standard deduction for real property taxes paid (up to $500; $1,000 if MFJ) was *not* extended to 2010.
4-20	Exemptions	The AGI-based phase-out of the deduction for personal exemptions does not apply for 2010–2012.
5-1	Limit on Itemized Deductions	The AGI-based phase-out of itemized deductions does not apply for 2010–2012.
5-5	State and Local General Sales Taxes	Election to deduct state and local general sales taxes (in lieu of state and local income taxes) is extended to 2010 and 2011.
5-12	Qualified Conservation Contributions	The higher AGI limit (50%; 100% for qualified farmers and ranchers) is extended to 2010 and 2011.
5-15	Deductible Casualty Losses—Limits	The $500 per-casualty reduction amount was *not* extended to 2010.
5-15	Federally Declared Disasters—Quick Summary of Special Tax Relief Provisions	The expired special relief provisions were *not* extended to federally declared disasters occurring in 2010.
6-14	Qualified Disaster Loss	The longer five-year carryback period for an NOL attributable to a federally declared disaster was *not* extended to losses occurring in 2010.
6-21	Farm Equipment	The five-year recovery period for new farm machinery and equipment was *not* extended for assets placed in service in 2010.
6-22	Qualified Production Activities Income	The provision that includes qualified production activities performed in Puerto Rico in the domestic production gross receipts calculation is extended to 2010 and 2011.
7-1	Basis for Computing Gain or Loss	Property inherited from a decedent who died in 2010 will have a basis equal to FMV at date of death and automatically have a long-term holding period unless the estate's executor elects to be exempt from the estate tax. If so, the modified carryover basis rules apply.
7-15	Inherited Houses	See comment above regarding property inherited from a decedent who died in 2010.
9-7	Educators	The up-to-$250 educator's expense deduction is extended to 2010 and 2011.

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2010 Tax Relief Act—Handbook Update Guide (Continued)

Page	***Section or Table Title***	***Change/Comment***
10-2	MACRS Recovery Periods (2010)—Agriculture	The five-year recovery period for new farm machinery and equipment was *not* extended to 2010.
10-2	MACRS Recovery Periods (2010)—Real Property	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
10-8	Special Depreciation Allowance	For qualifying property placed in service in 2010, the special depreciation allowance rate is as follows: • Property acquired and placed in service 1/1/10–9/8/10: 50%. • Property acquired and placed in service 9/9/10–12/31/10: 100%.
10-13	Leasehold Improvements, Retail and Restaurant Property—Special Rules (2010)	The 15-year MACRS recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
11-1	Business Vehicles—Quick Facts	For 2010, the increased depreciation limits (annual Section 280F limits) that apply when 50% special depreciation is claimed also apply when 100% special depreciation is claimed (for property placed in service 9/9/10–12/31/10). However, the basis amount at which the Section 280F limits apply when 100% special depreciation is claimed is $11,060 for passenger autos and $11,160 for trucks and vans.
11-3	2010 Deduction Limits for Vehicles	See above.
11-3	Calculating Vehicle Depreciation	Step 4: For new vehicles acquired 9/9/10-12/31/10, the special bonus allowance is 100%.
11-6	Depreciating Vehicles Acquired in a Trade	References to special depreciation should include both 50% and 100% special depreciation (100% if purchased 9/9/10–12/31/10).
11-6	Example	Change the 2010 acquisition month from November to August so the 50% special depreciation rate used in the calculation is correct. (If November acquisition, 100% special depreciation would apply rather than 50%.)
11-14	Vehicles Subject to Section 280F Limit Depreciation Worksheet	Line 16—the rate used for special depreciation should be 100% for qualified vehicles purchased 9/9/10–12/31/10.
12-1, 12-2	Tax Credits Summary—Allowed Against AMT?	The provision allowing all personal credits to offset AMT as well as regular tax is extended to 2010 and 2011. Therefore, the child and dependent care, lifetime learning, elderly or disabled and the personal energy property credits should be changed to "yes."
12-3	Child and Dependent Care Credit	The child and dependent care credit can offset both regular tax and AMT in 2010 and 2011.
12-8	Education Tax Credits—AMT	The lifetime learning credit can offset both regular tax and AMT in 2010 and 2011.
12-12	Personal Energy Property Credit	The personal energy property credit can offset both regular tax and AMT in 2010 and 2011.
12-15	AMT Exemption Amounts	The 2010 AMT exemption amounts are: $72,450 for MFJ and QW; $47,450 for Single and HOH and $36, 225 for MFS. Thus, the exemptions are eliminated at AMTI of: $439,800 for MFJ and QW; $302,300 for Single and HOH and $219,900 for MFS.
12-26	Percentage Depletion Quick Facts—Net Income Limit	The 100%-of-net-income limit that normally applies is suspended for 2010 and 2011 for marginal production properties.
13-4	Tuition and Fees Deduction	Tuition and fees deduction is extended to 2010 and 2011.
13-5	Education Tax Incentives Comparison Chart (2010)	Tuition and fees deduction is extended to 2010 and 2011.
14-13	Qualified Charitable Distributions (QCDs)	Qualified charitable distributions (QCDs) are allowed for 2010 and 2011. **Note:** Taxpayers can elect to treat QCDs made in January 2011 as occurring on December 31, 2010.
14-21	Social Security and Medicare Highlights	For 2011, the Social Security tax rate is 4.2% for employees and 10.4% for self-employed individuals. The maximum Social Security tax paid is $4,485.60 for employees and $11,107.20 for self-employed individuals.

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2010 Tax Relief Act—Handbook Update Guide (Continued)		
Page	***Section or Table Title***	***Change/Comment***
15-1	Estate Tax	An estate tax exclusion of $5 million and a maximum estate tax rate of 35% apply to decedents who died in 2010. Alternatively, the executor can elect to be exempt from estate tax, in which case, the basis of property acquired from the decedent is determined under the modified carryover basis rules. The following updated tables are available at the Updates section at *Quickfinder.com* [under *1040 Quickfinder® Handbook (2010 Tax Year)*]: (1) *Federal Estate and Gift Tax Rates—Quick Tax Method*, (2) *Estate and Gift Tax Maximum Rate*s and (3) *Estate and Gift Tax Credit/Exclusion*.
15-3	Deceased Taxpayer—Tax Returns	For decedents who die any time from 1/1/10–12/16/10, the deadline for filing Form 706 (and paying estate tax) is extended until no earlier than nine months after date of enactment (12/17/10). Also, footnote 2 only applies when the executor elects to be exempt from the estate tax.
15-5	Basis of Inherited Property—Decedent Died in 2010	The basis of property acquired from a decedent who died in 2010 is generally the property's FMV at the date of death, unless the executor elects to be exempt from estate tax, in which case, the modified carryover basis rules apply.
15-8	Federal Estate Tax	An estate tax exclusion of $5 million and a maximum estate tax rate of 35% apply to decedents who died in 2010. Alternatively, the executor can elect to be exempt from estate tax, in which case the basis of property acquired from the decedent is determined under the modified carryover basis rules.
17-2	Tax Extenders Legislation	An updated table showing whether these provisions were extended is available at the Updates section of *Quickfinder.com*, under *1040 Quickfinder® Handbook (2010 Tax Year)*.

Notes

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1040 Quickfinder® HANDBOOK

Form 1040
2010 Tax Year

2010 Key Amounts

Standard Deduction:		Earned Income Credit (Maximum):	
MFJ or QW[1]	$11,400	No children	$ 457
Single[2]	5,700	1 child	3,050
HOH[2]	8,400	2 children	5,036
MFS[1]	5,700	>2 children	5,666
Dependent[2]	950[3]	Investment income limit	3,100
Personal Exemption	$3,650	**Kiddie Tax Threshold**	$ 1,900
Standard Mileage Rates:		**Section 179 Deduction Limits:**	
Business	50¢	Overall	$500,000
Medical/moving	16.5¢	SUV (per vehicle)	25,000
Charitable	14¢	Qualified real property	250,000

[1] Add $1,100 for age 65 or older or blind, each.
[2] Add $1,400 for age 65 or older or blind, each.
[3] If greater, amount of earned income plus $300 (but not to exceed $5,700).

Social Security Highlights

Maximum Earnings Subject to:		2010	2011
Social Security tax		$106,800	$106,800
Medicare tax		No Limit	No Limit
Tax Rates			
Employee:	Social Security tax	6.20%	4.20 ~~6.20~~%
	Medicare tax	1.45	1.45
Self Employed:	Social Security tax	12.40	10.40 ~~12.40~~
	Medicare tax	2.90	2.90
Maximum Earnings and Still Receive Full Benefits:			
Under full retirement age (FRA)		$ 14,160	$ 14,160
Year FRA reached		37,680	37,680
FRA or older		No Limit	No Limit

2010 Quick Tax Method*

Taxable Income			× Rate		Subtract		
MFJ or QW Taxable Income							
$ 0	–	$ 16,750	× 10%	minus	$ 0.00	=	Tax
16,751	–	68,000	× 15%	minus	837.50	=	Tax
68,001	–	137,300	× 25%	minus	7,637.50	=	Tax
137,301	–	209,250	× 28%	minus	11,756.50	=	Tax
209,251	–	373,650	× 33%	minus	22,219.00	=	Tax
373,651	and over		× 35%	minus	29,692.00	=	Tax
Single Taxable Income							
$ 0	–	$ 8,375	× 10%	minus	$ 0.00	=	Tax
8,376	–	34,000	× 15%	minus	418.75	=	Tax
34,001	–	82,400	× 25%	minus	3,818.75	=	Tax
82,401	–	171,850	× 28%	minus	6,290.75	=	Tax
171,851	–	373,650	× 33%	minus	14,883.25	=	Tax
373,651	and over		× 35%	minus	22,356.25	=	Tax
HOH Taxable Income							
$ 0	–	$ 11,950	× 10%	minus	$ 0.00	=	Tax
11,951	–	45,550	× 15%	minus	597.50	=	Tax
45,551	–	117,650	× 25%	minus	5,152.50	=	Tax
117,651	–	190,550	× 28%	minus	8,682.00	=	Tax
190,551	–	373,650	× 33%	minus	18,209.50	=	Tax
373,651	and over		× 35%	minus	25,682.50	=	Tax
MFS Taxable Income							
$ 0	–	$ 8,375	× 10%	minus	$ 0.00	=	Tax
8,376	–	34,000	× 15%	minus	418.75	=	Tax
34,001	–	68,650	× 25%	minus	3,818.75	=	Tax
68,651	–	104,625	× 28%	minus	5,878.25	=	Tax
104,626	–	186,825	× 33%	minus	11,109.50	=	Tax
186,826	and over		× 35%	minus	14,846.00	=	Tax

* Assumes taxable income is all ordinary income. Multiply taxable income by the applicable tax rate and subtract the amount shown. Although this method differs from the IRS Tax Rate Schedules, the results are the same.

Caution: IRS Tax Tables must be used for taxable income under $100,000. To calculate the exact tax using the Quick Tax Method for taxable income under $100,000, round taxable income to the nearest $25 or $75 increment before using the formula. Round $50 or $100 increments up.

2010 AGI Phase-Out Amounts/Ranges

Filing Status	Tuition and Fees Deduction[1]	Student Loan Interest Deduction	Education Savings Bond Interest Exclusion	Lifetime Learning Credit	American Opportunity Credit	Education Savings Account (ESA)
MFJ	$130,000 / $160,000	$120,000 – $150,000	$105,100 – $135,100	$100,000 – $120,000	$160,000 – $180,000	$190,000 – $220,000
QW	65,000 / 80,000	60,000 – 75,000	105,100 – 135,100	50,000 – 60,000	80,000 – 90,000	95,000 – 110,000
Single	65,000 / 80,000	60,000 – 75,000	70,100 – 85,100	50,000 – 60,000	80,000 – 90,000	95,000 – 110,000
HOH	65,000 / 80,000	60,000 – 75,000	70,100 – 85,100	50,000 – 60,000	80,000 – 90,000	95,000 – 110,000
MFS	Do Not Qualify	Do Not Qualify	Do Not Qualify	Do Not Qualify	Do Not Qualify	95,000 – 110,000

Filing Status	Child Tax Credit[2]	Saver's Credit[3]	Earned Income Credit[3] No Child	1 Child	2 Children	>2 Children	Traditional IRA Deduction[4]	Roth IRA Contribution	Adoption Credit/Assistance
MFJ	$110,000	$ 55,500	$18,470	$40,545	$45,373	$48,362	$ 89,000 – $109,000	$167,000 – $177,000	$182,520 – $222,520
QW	75,000	27,750	13,460	35,535	40,363	43,352	89,000 – 109,000	167,000 – 177,000	182,520 – 222,520
Single	75,000	27,750	13,460	35,535	40,363	43,352	56,000 – 66,000	105,000 – 120,000	182,520 – 222,520
HOH	75,000	41,625	13,460	35,535	40,363	43,352	56,000 – 66,000	105,000 – 120,000	182,520 – 222,520
MFS	55,000	27,750	Do Not Qualify				0[5] – 10,000	0[5] – 10,000	Do Not Qualify

[1] The phase-out amounts for the $4,000 and $2,000 deductions, respectively, are shown. ~~**Caution:** Deduction expired after 2009 but may be extended. See *Tax Extenders Legislation* on Page 17-1.~~
[2] Amount at which phase-out begins.
[3] Amount at which phase-out is complete.
[4] Phase-out only applies if taxpayer is an active participant in a retirement plan. For MFJ, phase-out range for non-participating spouse is $167,000 – $177,000.
[5] Married individuals filing MFS who live apart at all times during the year are treated as single.

Quick Facts, Worksheets, Where to File

All worksheets included in Tab 3 may be copied and used in your tax practice.

Tab 3 Topics

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Business Use of Home Worksheet .... Page 3-4
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Net Operating Loss Worksheet #1 .... Page 3-10
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Quick Facts Data Sheet

	2011	2010	2009	2008	2007
General Deductions and Credits					
Standard deduction:					
MFJ or QW	$ 11,600	$ 11,400	$ 11,400	$ 10,900	$ 10,700
Single	5,800	5,700	5,700	5,450	5,350
HOH	8,500	8,400	8,350	8,000	7,850
MFS	5,800	5,700	5,700	5,450	5,350
Additional for age 65 or older or blind each (MFJ, QW, MFS)	1,150	1,100	1,100	1,050	1,050
Additional for age 65 or older or blind each (Single, HOH)	1,450	1,400	1,400	1,350	1,300
Itemized deduction phase-out begins at AGI of:					
MFJ, QW, Single or HOH	N/A	N/A	$ 166,800	$ 159,950	$ 156,400
MFS	N/A	N/A	83,400	79,975	78,200
Personal/dependent exemption	$ 3,700	$ 3,650	$ 3,650	$ 3,500	$ 3,400
Personal exemption phase-out begins at AGI of: [2]					
MFJ or QW	N/A	N/A	$ 250,200	$ 239,950	$ 234,600
Single	N/A	N/A	166,800	159,950	156,400
HOH	N/A	N/A	208,500	199,950	195,500
MFS	N/A	N/A	125,100	119,975	117,300
Earned income credit:					
Earned income and AGI must be less than (MFJ): [3]					
No qualifying children	$ 18,740	$ 18,470	$ 18,440	$ 15,880	$ 14,590
One qualifying child	41,132	40,545	40,463	36,995	35,241
Two qualifying children	46,044	45,373	45,295	41,646	39,783
Three or more qualifying children	49,078	48,362	48,279	41,646	39,783
Maximum amount of credit (all filers except MFS):					
No qualifying children	$ 464	$ 457	$ 457	$ 438	$ 428
One qualifying child	3,094	3,050	3,043	2,917	2,853
Two qualifying children	5,112	5,036	5,028	4,824	4,716
Three or more qualifying children	5,751	5,666	5,657	4,824	4,716
Investment income limit	3,150	3,100	3,100	2,950	2,900
Child tax credit:					
Credit per child	$ 1,000	$ 1,000	$ 1,000	$ 1,000	$ 1,000
Additional (refundable) credit—earned income floor	3,000	3,000	3,000	8,500	11,750
Adoption credit:					
Maximum credit (and amount allowed for adoption of special needs child)	$ 13,360	$ 13,170	$ 12,150	$ 11,650	$ 11,390
Credit phase-out begins at AGI of:					
All taxpayers except MFS	$ 185,210	$ 182,520	$ 182,180	$ 174,730	$ 170,820
MFS	Not Allowed	Not Allowed	Not Allowed	Not Allowed	Not Allowed
Kiddie tax unearned income threshold	$ 1,900	$ 1,900	$ 1,900	$ 1,800	$ 1,700
Foreign earned income exclusion	$ 92,900	$ 91,500	$ 91,400	$ 87,600	$ 85,700

Table continued on the next page

Quick Facts Data Sheet (Continued)

	2011	2010	2009	2008	2007
FICA/SE Taxes					
Maximum earnings subject to tax:					
Social Security tax	$ 106,800	$ 106,800	$ 106,800	$ 102,000	$ 97,500
Medicare tax	No Limit	No Limit	No Limit	No Limit	No Limit
Maximum tax paid by:					
Employee—Social Security	$ 4,485.60	$ 6,621.60	$ 6,621.60	$ 6,324	$ 6,045
Self-employed—Social Security	11,107.20	13,243.20	13,243.20	12,648	12,090
Employee or self-employed—Medicare	No Limit	No Limit	No Limit	No Limit	No Limit
Business Deductions					
Section 179 deduction—limit	$ 500,000	$ 500,000	$ 250,000	$ 250,000	$ 125,000
Section 179 deduction—SUV limit (per vehicle)	25,000	25,000	25,000	25,000	25,000
Section 179 deduction—qualified real property limit	250,000	250,000	N/A	N/A	N/A
Section 179 deduction—qualifying property phase-out threshold	2,000,000	2,000,000	800,000	800,000	500,000
Depreciation limit—autos (1st year)	[1]	3,060[4]	2,960[4]	2,960[4]	3,060
Depreciation limit—trucks and vans (1st year)	[1]	3,160[4]	3,060[4]	3,160[4]	3,260
Standard mileage allowances:					
Business	51¢	50¢	55¢	50.5¢ / 58.5¢	48.5¢
Charity work	14¢	14¢	14¢	14¢	14¢
Medical/moving	19¢	16.5¢	24¢	19¢ / 27¢	20¢
Health Care Deductions					
Health savings accounts (HSAs):					
Self-only coverage: Contribution limit	$ 3,050	$ 3,050	$ 3,000	$ 2,900	$ 2,850
Plan minimum deductible	1,200	1,200	1,150	1,100	1,100
Plan out-of-pocket limit	5,950	5,950	5,800	5,600	5,500
Family coverage: Contribution limit	6,150	6,150	5,950	5,800	5,650
Plan minimum deductible	2,400	2,400	2,300	2,200	2,200
Plan out-of-pocket limit	11,900	11,900	11,600	11,200	11,000
Additional contribution limit—age 55 or older	1,000	1,000	1,000	900	800
Long-term care insurance—deduction limits:					
Age 40 and under	$ 340	$ 330	$ 320	$ 310	$ 290
Age 41 – 50	640	620	600	580	550
Age 51 – 60	1,270	1,230	1,190	1,150	1,110
Age 61 – 70	3,390	3,290	3,180	3,080	2,950
Age 71 and older	4,240	4,110	3,980	3,850	3,680
Long-term care—excludible per diem	$ 300	$ 290	$ 280	$ 270	$ 260
Medical savings accounts (MSAs):					
Self-only coverage: Plan minimum deductible	$ 2,050	$ 2,000	$ 2,000	$ 1,950	$ 1,900
Plan maximum deductible	3,050	3,000	3,000	2,900	2,850
Plan out-of-pocket limit	4,100	4,050	4,000	3,850	3,750
Family coverage: Plan minimum deductible	4,100	4,050	4,000	3,850	3,750
Plan maximum deductible	6,150	6,050	6,050	5,800	5,650
Plan out-of-pocket limit	7,500	7,400	7,350	7,050	6,900
Education Tax Incentives					
Education savings accounts (ESAs) phase-out begins at AGI of:					
MFJ	$ 190,000	$ 190,000	$ 190,000	$ 190,000	$ 190,000
Single, HOH, QW and MFS	95,000	95,000	95,000	95,000	95,000
Hope/American Opportunity Credit—maximum credit (per student)	$ 2,500	$ 2,500	$ 2,500	$ 1,800	$ 1,650
Lifetime learning credit (LLC)—maximum credit (per return)	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000
Education credit phase-out begins at AGI of:					
MFJ — Hope/American Opportunity:	$ 160,000	$ 160,000	$ 160,000	$ 96,000	$ 94,000
MFJ — LLC:	102,000	100,000	100,000	96,000	94,000
Single, HOH and QW — Hope/American Opportunity:	80,000	80,000	80,000	48,000	47,000
Single, HOH and QW — LLC:	51,000	50,000	50,000	48,000	47,000
MFS	Not Allowed	Not Allowed	Not Allowed	Not Allowed	Not Allowed
Student loan interest deduction limit	$ 2,500	$ 2,500	$ 2,500	$ 2,500	$ 2,500
Student loan interest deduction phase-out begins at AGI of:					
MFJ	$ 120,000	$ 120,000	$ 120,000	$ 115,000	$ 110,000
Single, HOH and QW	60,000	60,000	60,000	55,000	55,000
MFS	Not Allowed	Not Allowed	Not Allowed	Not Allowed	Not Allowed

Table continued on the next page

Quick Facts Data Sheet (Continued)

	2011	2010	2009	2008	2007
Savings bonds income exclusion phase-out begins at AGI of:					
MFJ and QW	$ 106,650	$ 105,100	$ 104,900	$ 100,650	$ 98,400
Single and HOH	71,100	70,100	69,950	67,100	65,600
MFS	Not Allowed	Not Allowed	Not Allowed	Not Allowed	Not Allowed
Tuition deduction phase-out begins at AGI of:					
MFJ	$ 130,000	$ 130,000	$ 130,000	$ 130,000	$ 130,000
Single, HOH and QW	65,000	65,000	65,000	65,000	65,000
MFS	Not Allowed	Not Allowed	Not Allowed	Not Allowed	Not Allowed
Alternative Minimum Tax (AMT)					
AMT exemption:					
MFJ or QW	$ 74,450	$ 72,450	$ 70,950	$ 69,950	$ 66,250
Single or HOH	48,450	47,450	46,700	46,200	44,350
MFS	37,225	36,225	35,475	34,975	33,125
Child subject to kiddie tax—earned income plus	6,800	6,700	6,700	6,400	6,300
Retirement Plans					
IRA contribution limits:					
Under age 50	$ 5,000	$ 5,000	$ 5,000	$ 5,000	$ 4,000
Age 50 or older	6,000	6,000	6,000	6,000	5,000
Traditional IRA deduction phase-out begins at AGI of (active employer retirement plan participants):					
MFJ and QW (participating spouse)	$ 90,000	$ 89,000	$ 89,000	$ 85,000	$ 83,000
MFJ (non-participating spouse)	169,000	167,000	166,000	159,000	156,000
Single and HOH	56,000	56,000	55,000	53,000	52,000
MFS	0	0	0	0	0
Roth IRA contribution phase-out begins at AGI of:					
MFJ and QW	$ 169,000	$ 167,000	$ 166,000	$ 159,000	$ 156,000
Single and HOH	107,000	105,000	105,000	101,000	99,000
MFS	0	0	0	0	0
Roth IRA conversion—AGI limit:					
MFJ, Single, HOH	N/A	N/A	$ 100,000	$ 100,000	$ 100,000
MFS	N/A	N/A	Not Allowed	Not Allowed	Not Allowed
SIMPLE IRA plan elective deferral limits:					
Under age 50	$ 11,500	$ 11,500	$ 11,500	$ 10,500	$ 10,500
Age 50 or older	14,000	14,000	14,000	13,000	13,000
401(k), 403(b), 457 and SARSEP elective deferral limits:					
Under age 50	$ 16,500	$ 16,500	$ 16,500	$ 15,500	$ 15,500
Age 50 or older	22,000	22,000	22,000	20,500	20,500
Profit-sharing plan/SEP contribution limits	$ 49,000	$ 49,000	$ 49,000	$ 46,000	$ 45,000
Compensation limit (for employer contributions to profit sharing plans)	$ 245,000	$ 245,000	$ 245,000	$ 230,000	$ 225,000
Defined benefit plans—annual benefit limit	$ 195,000	$ 195,000	$ 195,000	$ 185,000	$ 180,000
Retirement saver's credit phased-out when AGI exceeds:					
MFJ	$ 56,500	$ 55,500	$ 55,500	$ 53,000	$ 52,000
HOH	42,375	41,625	41,625	39,750	39,000
Single, MFS, QW	28,250	27,750	27,750	26,500	26,000
"Key employee" compensation threshold	$ 160,000	$ 160,000	$ 160,000	$ 150,000	$ 145,000
"Highly compensated" threshold	$ 110,000	$ 110,000	$ 110,000	$ 105,000	$ 100,000
Social Security					
Maximum earnings and still receive full Social Security benefits:					
Under full retirement age (FRA) at year-end, benefits reduced by $1 for each $2 earned over:	$ 14,160	$ 14,160	$ 14,160	$ 13,560	$ 12,960
Year FRA reached, benefits reduced $1 for each $3 earned over (months up to FRA only):	37,680	37,680	37,680	36,120	34,440
Month FRA reached and later:	No Limit	No Limit	No Limit	No Limit	No Limit
Estate and Gift Taxes					
Estate tax exclusion	$ 5,000,000[6]	$ 5,000,000[5]	$ 3,500,000	$ 2,000,000	$ 2,000,000
Gift tax exclusion	$ 5,000,000[6]	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000
GST tax exemption	$ 5,000,000	$ 5,000,000	$ 3,500,000	$ 2,000,000	$ 2,000,000
Gift tax annual exclusion	$ 13,000	$ 13,000	$ 13,000	$ 12,000	$ 12,000

[1] Amount not released by IRS at publication time. When these amounts are available, an updated table will be posted to the Updates section of *Quickfinder.com*.
[2] Regardless of AGI, the exemption cannot be reduced below $2,433 (2009); $2,333 (2008) and $1,133 (2007).
[3] To get earned income/AGI phaseout amount for all other filers (except MFS), reduce amount shown by: $5,080 in 2011; $5,010 in 2010; $5,000 in 2009; $3,000 in 2008; $2,000 in 2007.
[4] Add $8,000 if special depreciation claimed.
[5] Executor can elect that the estate not be subject to estate tax. If so, basis of property acquired from the decedent is determined under the modified carryover basis rules.
[6] Plus the amount, if any, of deceased spousal unused exclusion amount.

State and Local General Sales Tax Deduction Worksheet

For 2009, ... nd local
income ... time,
Congre... *ders*

If exte... of
Quickfinder.com.

2010 worksheet available—see *State and Local Tax Deduction Worksheet (2010)* under *1040 Quickfinder Handbook (2010 Tax Year)* in the Updates section of *Quickfinder.com*

Student Loan Interest Deduction Worksheet

Caution: Do not use this worksheet if taxpayer filed Form 2555 or 2555-EZ (related to foreign earned income) or Form 4563 (income exclusion for residents of American Samoa) or if taxpayer is excluding income from sources within Puerto Rico. Use the worksheet in IRS Pub. 970 instead.

1) Enter the total interest paid in 2010 on qualified student loans. **Do not** enter more than $2,500 .... 1) ________

2) Enter the amount from Form 1040, line 22 .... 2) ________

3) Enter the total of the amounts from Form 1040, lines 23 through 32, plus any write-in adjustments entered on the dotted line next to line 36 .... 3) ________

4) Subtract line 3 from line 2 .... 4) ________

5) Enter the amount shown below for taxpayer's filing status:
   - Single, HOH or QW—$60,000
   - MFJ—$120,000 .... 5) ________

6) Is the amount on line 4 more than the amount on line 5? ....

   No ☐ Skip lines 6 and 7, enter -0- on line 8 and go to line 9.

   Yes ☐ Subtract line 5 from line 4 .... 6) ________

7) Divide line 6 by $15,000 ($30,000 if MFJ). Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000 .... 7) ________

8) Multiply line 1 by line 7 .... 8) ________

9) **Student loan interest deduction.** Subtract line 8 from line 1. Enter the result here and on Form 1040, line 33. Do not include this amount in figuring any other deduction on taxpayer's return (such as on Schedules A, C, E, etc.) .... 9) ________

- *Fourth-quarter estimate paid in January.* The taxpayer made the last payment of 2009 estimated state or local income tax in 2010. Pro-rate the refund. If estimated tax was paid in four equal installments, report 75% of the refund as taxable income on line 10. Reduce state tax deducted on Schedule A by 25% of the refund. Attach a calculation explaining why the entire amount from Form 1099-G is not reported on line 10.
- *Other refunds.* The taxpayer received other refunds, such as general sales tax or real property taxes, in 2010 of amounts deducted in an earlier tax year.
- *Allowable sales tax deduction.* Refund is more than the 2009 state and local income tax deduction minus the amount the taxpayer could have deducted for 2009 state and local general sales taxes.
- *Alternative minimum tax owed or credits exceeded tax.* The taxpayer owed AMT in 2009 or nonrefundable credits exceeded tax in 2009. Recompute the earlier year's tax including the refund amount as income. If inclusion of the refund does not change the total tax, the refund does not need to be reported as income in 2010.
- *Itemized deductions were limited.* The taxpayer's 2009 AGI was over $166,800 ($83,400 MFS). See *Tax Benefit Rule* under *Recoveries* in Publication 525.

State and Local Tax Refund Worksheet
(See Form 1040 instructions if MFS in 2009.)

1)	Enter the income tax refund. Do not enter more than income tax deducted on line 5a of 2009 Schedule A, line 5	1)______
2)	Enter total allowable itemized deductions from line 29 of the 2009 Schedule A	2)______
3)	Enter the amount shown below for the filing status claimed on the 2009 Form 1040	3)______
	• $5,700 Single • $8,350 HOH • $11,400 MFJ or QW • $5,700 MFS not required to itemize	
4)	Multiply the number in the box on line 39a of the 2009 Form 1040 by $1,100 ($1,400 if single or HOH in 2009)	4)______
5)	Enter the *smaller* of real estate taxes on the 2009 Sch. A, line 6 (not including any foreign taxes) or $500 ($1,000 if MFJ)	5)______
6)	Enter any net disaster loss from the 2009 Form 4684, line 18	6)______
7)	Enter any new motor vehicle taxes from 2009 Schedule A, line 7	7)______
8)	Add lines 3, 4, 5, 6 and 7	8)______
9)	Subtract line 8 from line 2. If zero or less, enter -0-	9)______
10)	**Taxable part of refund.** Enter the smaller of line 1 or line 9 here and on line 10 of Form 1040	10)______

Alimony Received

See Alimony on Page 13-10 and IRS Publication 504.

Business Income/Loss

See Tab 6.

Capital Gain/Loss

See Tab 7.

Schedule D is not required if the only amounts reportable on Schedule D are capital gain distributions from box 2a of Form 1099-DIV and there are no amounts in boxes 2b (unrecaptured Section 1250 gain), 2c (Section 1202 gain), or 2d [collectibles (28%) gain]. Enter capital gain distributions on line 13 and check the box on that line. Use the *Qualified Dividends and Capital Gain Tax Worksheet* in the Form 1040 instructions to calculate tax.

Other Gains/Losses

See Sales of Business Property on Page 7-10.

IRA Distributions

See Tab 14.

Distributions and rollovers from traditional, Roth, SEP and SIMPLE IRAs are reported on lines 15a and 15b. Conversions of traditional, SEP and SIMPLE IRAs to Roth IRAs are also reported on lines 15a and 15b. Penalties for early withdrawals from those accounts are reported on line 58.

Rollovers. Enter the total distribution on line 15a and write "Rollover" next to line 15b. If the entire distribution was rolled over, enter zero on line 15b; otherwise, enter the amount not rolled over on line 15b unless Form 8606 is required as described below. Trustee-to-trustee transfers between IRAs do not need to be reported and a Form 1099-R should not be received.

If the IRA distribution was rolled over into a qualified plan other than an IRA, or the rollover occurred in 2011, attach a statement explaining the rollover.

Distributions—Traditional/SEP/SIMPLE IRAs:

- *Fully taxable distributions.* Leave line 15a blank and report the entire amount on line 15b.
- *Nondeductible contributions.* Enter the total distribution on line 15a. If the taxpayer made nondeductible contributions to an IRA in previous years, use Form 8606 to calculate the taxable amount to report on line 15b.

Roth IRA distributions. Enter the total distribution on line 15a. Use Form 8606 to calculate the taxable amount to enter on line 15b. However, if the distribution is a qualified distribution or nontaxable due to an exception (Code Q or T in box 7 of Form 1099-R), enter zero on line 15b and do not complete Form 8606.

Roth conversions. Enter total distribution on line 15a. Use Form 8606 to calculate the taxable amount entered on line 15b.

Returned and recharacterized contributions. See Form 8606 and its instructions for information on how to compute and report on lines 15a and 15b the return of an excess IRA contribution (and related earnings). This includes the return of a 2009 or 2010 IRA contribution (with earnings) before the due date (including extensions) of the return for that year, excess IRA contributions for earlier years returned in 2010 or the recharacterization of part or all of a 2010 Roth or traditional IRA contribution.

Qualified charitable distribution (QCD). Enter the total distribution on line 15a. If the total distribution was a QCD, enter -0- on line 15b; if only part was a QCD, enter the non-QCD amount on line 15b (unless it's not taxable because of another exception) and write "QCD" next to line 15b. See *Qualified Charitable Distributions (QCDs)* on Page 14-13. ~~**Caution:** The QCD provision expired after 2009. However, at publication date, Congress was considering legislation extending this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Health savings account (HSA) funding distribution (HFD). An HFD is a one-time nontaxable distribution made directly by the trustee of the taxpayer's IRA (other than SEP or SIMPLE IRAs) to the taxpayer's HSA. A taxpayer who elects this treatment reports the total IRA distribution on line 15a and the taxable amount (amount of distribution that was not an HFD) on line 15b. Enter "HFD" next to line 15b.

Multiple exceptions. Attach a statement showing the amount for each exception instead of making an entry on line 15b.

Pensions and Annuities

See Tab 14 and Form 1099-R, Box 7 Distribution Codes on Page 14-13.

Fully taxable distributions. Distributions from pensions and annuities are fully taxable if: (1) the taxpayer did not contribute to the

Nondeductible expenses include:

- Expenses of buying and/or selling a home.
- Meal expenses.
- Pre-move househunting expenses.
- Temporary living expenses.

General rules for moving expenses:

1) *Distance test*. To deduct moving expenses, the distance between the taxpayer's new job location and former house must be at least 50 miles more than the distance between the old job location and former house.

   Note for first-time employees or persons returning to work: If there is no established old job location, the distance test is met if the new workplace is at least 50 miles from the former home.

Moving Expenses—Distance Test	
1) Enter # of miles from old home to new workplace.....................	_____mi
2) Enter # of miles from old home to old workplace	_____mi
Subtract line 2 from line 1. If 50 or more, distance test is met..........	_____mi

2) *Time test:*
   - *Employee.* Moving costs are deductible only if the taxpayer works as a full-time employee at the new location for at least 39 weeks in the 12-month period following arrival. For married taxpayers, only one spouse need satisfy the full-time work test.
   - *Self-employed individuals* must work full-time for at least 39 weeks during the first 12 months and a total of at least 78 weeks during the first 24 months after arriving at the new job location. For this test, the taxpayer can count any full-time work as an employee or as a self-employed person.
   - *Fail to meet test*. If in a later year the time test is not met, the taxpayer must either (1) report the moving expense deduction as other income on Form 1040 or (2) amend the prior-year return.
   - *Exceptions:* The time test will not apply if one expected the job to last 39/78 weeks but lost it because of involuntary separation—other than for willful misconduct. *Other Exceptions:* Death, disability, re-transfer by employer or military.
   - *IRS ruling:* If the employee initiates a transfer before putting in the required 39 weeks of work, moving expenses are not deductible. The transfer must be beyond the control of the employee. (Rev. Rul. 88-47)
   - *Combine two jobs.* If the employee leaves the first job without meeting the time requirements and gets a second job in the same general location, time spent on the two jobs may be combined to meet the 39-week rule.
3) *Other considerations.* The IRS allows a deduction only for a move "closely related" in time to the start of work at the new job location. Generally, the requirement is satisfied only when moving expenses are incurred within one year from the date a person first reports to work. If more than one year between the start of the job and the move, expenses are not deductible unless circumstances prevented the move within that time. Each case is judged by its own facts, but generally extra time is justified to allow a spouse to fulfill job commitments in the old location or for children to finish a segment of schooling.
4) *Armed Forces.* A member of the Armed Forces on active duty who moves because of a permanent change of station does not have to meet the distance and time tests.

One-Half Self-Employment Tax

Enter amount from line 6 (Short Schedule SE) or line 13 (Long Schedule SE) on line 27.

Self-Employed SEP, SIMPLE and Qualified Plans

See Tab 14.

Enter deductible contributions to a self-employed qualified plan, SEP or SIMPLE plan made for the benefit of a self-employed taxpayer or partner on line 28. Contributions made for the benefit of the taxpayer's employees are deducted on Schedule C or F.

Self-Employed Health Insurance Deduction

See Part II—Expenses on Page 6-6.

Penalty on Early Withdrawal of Savings

Enter penalty from Form 1099-INT or 1099-OID for early withdrawal of savings or certificates on line 30. (Do not deduct the penalty from interest reported on line 8a.)

Alimony Paid

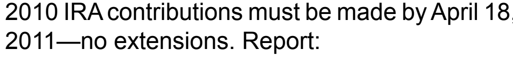
See Alimony on Page 13-10.

Enter alimony paid on line 31a. Include the recipient's Social Security number on line 31b. If the taxpayer made alimony payments to more than one person, enter one SSN on line 31b and attach a statement listing the numbers of the other alimony recipients.

To be deductible, alimony or separate maintenance payments must be required by a divorce or separation instrument and must meet several other requirements. Child support, property settlements and voluntary payments are not deductible alimony.

IRA Deduction

See Traditional IRAs on Page 14-4.



2010 IRA contributions must be made by April 18, 2011—no extensions. Report:

- Deductible IRA contributions for the taxpayer and spouse on line 32.
- Nondeductible contributions to a traditional IRA on Form 8606.
- 2010 conversion contributions to a Roth IRA (funds are moved from a traditional IRA or qualified plan to a Roth IRA or a traditional IRA is redesignated as a Roth IRA) on Form 8606. See *Roth IRA Conversions* on Page 14-7.

Student Loan Interest Deduction

See Student Loan Interest Deduction on Page 13-4 and IRS Publication 970.

The maximum deduction is $2,500 regardless of the number of students in taxpayer's family. Report on line 33.

No deduction is allowed if the taxpayer's filing status is MFS or if the taxpayer is claimed as a dependent on another return. If the taxpayer can be claimed as a dependent on another return, but the other taxpayer chooses not to claim the exemption, the taxpayer can deduct student loan interest (but cannot deduct his own dependency exemption).

Tuition and Fees Deduction

~~**Caution:** The tuition and fees deduction expired at the end of 2009 but at the time of publication, Congress was considering legislation that would extend it to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

See *Tuition and Fees Deduction* on Page 13-4.

The maximum deduction is $4,000 or $2,000, depending on modified AGI. Joint filers with modified AGI over $160,000 cannot claim the deduction (modified AGI of $80,000 for Single and HOH).

Form 8917, *Tuition and Fees Deduction*, is used to compute the allowable deduction, which is reported on line 34.

Domestic Production Activities Deduction

See Domestic Producer Deduction (DPD) on Page 6-22.

Total Adjustments

Add lines 23 through 35 and enter the total on line 36.

Include the following adjustments in the total on line 36, and enter the amount and description to the left of line 36:

Adjustment Item (Include in Line 36 Total)	Describe on Return as
Archer MSA deductions (see *Archer MSA deduction* below).	MSA
Attorneys fees paid in connection with a taxable IRS whistle-blower's award after 12/19/06.	WBF
Attorneys fees for settlements after 10/24/04, in connection with unlawful discrimination, but only to the extent of the amount included in income.	UDC
Contributions by certain chaplains to Section 403(b) plans.	403(b)
Contributions to Section 501(c)(18)(D) pension plans. This amount should be identified with Code H in box 12 of Form W-2.	501(c)(18)(D)
Expenses from the rental of personal property if the income from the rental of personal property was reported on line 21.	PPR
Forestation or reforestation amortization if the taxpayer could claim a deduction for these costs and did not have to file Schedule C, C-EZ or F.	RFST
Jury pay given to employer because employer continued to pay salary while on jury duty. (Also reported as income on line 21.)	Jury Pay
Repayment of supplemental unemployment benefits under the Trade Act of 1974. Alternatively, the taxpayer may be able to claim a credit against tax. See IRS Pub. 525.	Sub-Pay TRA

Archer MSA deduction. A medical savings account (MSA) is a trust established to pay for qualified medical expenses of the account holder. A participant must:

1) Work for a small employer or be self-employed and
2) Have a high-deductible health plan (HDHP). (IRC §220)

2010 MSA High-Deductible Health Plan		Individual Coverage	Family Coverage
Annual plan deductibles	Minimum	$2,000	$4,050
	Maximum	3,000	6,050
Out-of-pocket expense limitation		4,050	7,400
Maximum annual contribution		65% of deductible	75% of deductible

- Contributions are limited to net self-employment (SE) earnings or employee compensation from the business establishing the HDHP, and may be made by an employer, an employee or a self-employed individual.
- 2010 contributions must be made on or before April 18, 2011.
- Taxpayers will receive Form 5498-SA, which shows the amount contributed during the year. Taxpayers report all contributions on Form 8853. Enter the deductible amount in the total on line 36 of Form 1040 and write "MSA" to the left.
- Excess contributions are subject to a 6% penalty (calculated on Form 5329) unless the excess plus allocable income is distributed by the filing due date, including extensions.

Adjusted Gross Income

If line 37 is less than zero, the taxpayer may have an NOL [see *Net Operating Loss (NOL)* on Page 6-14] that can be carried to another year. See the NOL worksheets in Tab 3 and IRS Publication 536, *Net Operating Losses*.

Taxes and Credits

Age 65 or Older and Blind

Check all applicable boxes on line 39a for the taxpayer and spouse.

Age. For 2010, a taxpayer born before January 2, 1946 is considered age 65 or older.

Blindness:

- If the taxpayer or spouse is completely blind as of December 31, 2010, attach a statement describing the condition.
- If only partially blind, attach a copy of a statement certified by an eye doctor or optometrist that sight is not better than 20/200 in the better eye with glasses or contact lenses or the field of vision is 20 degrees or less. If a statement filed in a prior year certified that the condition was unlikely to improve, a new certified statement from the doctor or optometrist is not required. The taxpayer must keep the statement for his records.

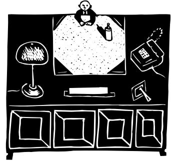
MFS and Spouse Itemizes Deductions or Dual-Status Alien

Check the box on line 39b if the taxpayer is MFS and his spouse itemizes deductions on a separate return (either MFS or HOH), or if the taxpayer is a dual-status alien. *Exception:* If the dual-status alien and his spouse who is a U.S. citizen file a joint return and both agree to be taxed on their combined worldwide income, do not check the box.

Note: Married taxpayers filing as HOH do not need to check this box, even if their spouse itemizes deductions. (CCA 200030023)

If the box on line 39b is checked, the standard deduction is zero.

Itemized/Standard Deduction



See Tab 5.

Enter the larger of itemized deductions or the standard deduction on line 40. If the box on line 39b is checked, the standard deduction is zero, even if the taxpayer is age 65 or older or blind. Standard deductions are listed on the front cover of this handbook.

Additional standard deduction (Schedule L). Taxpayers with either of the following use Schedule L to figure their standard deduction.

- *Losses from federally declared disasters.* Additional standard deduction equals the excess of taxpayer's 2010 personal casualty losses attributable to a 2008 or 2009 federally declared disaster over personal casualty gains. See *Federally Declared Disasters* on Page 5-15. **Caution:** The standard deduction is only increased for a net disaster loss if the disaster was declared after 2007 and occurred before 2010. ~~But, at the time of publication, Congress was considering legislation that would extend this provision to disasters occurring in 2010. See *Tax Extenders Legislation* on Page 17-1.~~
- *Qualified motor vehicle taxes that would be deductible if taxpayer itemized.* State or local sales or excise tax paid in 2010 on the purchase (up to $49,500) of certain new vehicles (autos, light trucks, motor cycles or motor homes) between February 17, 2009 and December 31, 2009 increases the standard deduction. The increase phases out when AGI exceeds $135,000 ($260,000 if MFJ).
- ~~*Real property taxes.* Additional standard deduction equals taxes that would be deductible if the taxpayer itemized, up to $500 ($1,000 if MFJ). **Caution:** This provision expired after 2009, but at the time of publication, Congress was considering legislation that would extend it to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Phase-out of itemized deductions. For 2010, itemized deductions are not subject to the phase-out rules. The AGI-based phase-out of itemized deductions is scheduled to return in 2011. [IRC §68(f)]

A taxpayer who elects to itemize deductions even though they are less than the standard deduction should complete Schedule A and check the box on line 30 of that schedule.

Strategy: It may be advantageous to itemize deductions even though less than the standard deduction when the taxpayer is subject to AMT because the standard deduction is added back for AMT purposes. Also, there may be instances when the tax benefit of being able to itemize deductions on the taxpayer's state tax return is greater than the tax benefit lost on his federal return by not taking the standard deduction.

Exemptions

General exemptions. Each exemption is worth $3,650 for 2010. Enter the allowable exemption deduction on line 42.

Note: The exemption deduction is not phased out based on the taxpayer's AGI in 2010. ~~However, the phase-out of the exemption deduction for higher-income taxpayers is scheduled to return in 2011.~~

Tax

Methods used to calculate tax. Enter the tax on line 44. Use the following to compute tax unless Form 8615, Schedule D, *Qualified Dividends and Capital Gain Worksheet*, *Foreign Earned Income Tax Worksheet,* or Schedule J applies.

- *Tax Table.* Use if taxable income is less than $100,000. See Tab 1.
- *Tax Computation Worksheet.* Use if taxable income is $100,000 or more. See *2010 Tax Computation Worksheet* on Page 1-13.

Form 8615. Use to figure the tax for children under age 18 [or age 18 (or full-time students age 19–23) whose earned income is less than or equal to half of their support] and who had more than $1,900 of investment income. Do not use if neither parent was alive on December 31, 2010. See *Kiddie Tax* on Page 13-1.

Schedule D tax worksheets. Use the worksheets in the Schedule D instructions to calculate tax if Schedule D is required and the taxpayer has 28% rate capital gains or unrecaptured Section 1250 gains (line 18 or line 19 of Schedule D).

Qualified dividends and capital gain tax worksheet. Use the *Qualified Dividends and Capital Gain Tax Worksheet* in the Form 1040 instructions to calculate tax if the Schedule D Tax Worksheets are not required and the taxpayer reports (a) qualified dividends on Form 1040, line 9b, (b) capital gain distributions on Form 1040, line 13 or (c) capital gains on Schedule D and lines 15 and 16 of Schedule D are both more than zero.

Foreign earned income tax worksheet. Use the Foreign Earned Income Tax Worksheet in the Form 1040 instructions if the taxpayer is claiming the foreign earned income exclusion or the housing exclusion or deletion on Form 2555.

Schedule J. Use Schedule J to calculate tax for farmers or fishermen who elect to income average. See *Schedule F—Profit/Loss From Farming* on Page 6-16.

Other tax reported on line 44. Include in total for line 44:

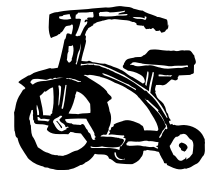
- Form 8814, *Parents' Election to Report Child's Interest and Dividends*. Check box (a) on line 44. See Tab 13.
- Form 4972, *Tax on Lump-Sum Distributions*. Check box (b) on line 44. See Tab 14.
- Recapture of an education credit. If a refund or tax-free educational assistance was received in 2010 for education costs for which an education credit was claimed in a prior year, all or part of the previously claimed education credit must be recaptured. If owed, enter the amount and "ECR" on the dotted line next to line 44 and include in the amount on line 44. See the Form 8863 instructions for details.

Alternative Minimum Tax

See Alternative Minimum Tax (AMT) on Page 12-15.

Foreign Tax Credit

See Foreign Tax Credit on Page 12-11.



Credit for Child and Dependent Care Expenses

See Child and Dependent Care Credit on Page 12-3.

Education Credits

See Education Tax Credits on Page 12-8.

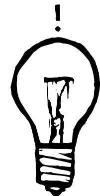
Retirement Savings Contributions Credit

See Retirement Saver's Credit on Page 12-13.

Child Tax Credit

See Child Tax Credit Worksheet (2010) on Page 3-5 and Child Tax Credits on Page 12-5.

If a child tax credit is claimed on line 51, check the box in column 4 of line 6c for each dependent claimed.



Residential Energy Credits

See Residential Energy Tax Credits on Page 12-12.

Other Credits

See the Tax Credit Summary (2010) table on Page 12-1.

Elderly or disabled credit (Schedule R). The taxpayer or spouse must be either:

- Age 65 or older by the end of 2010 or
- Under age 65 by the end of 2010, and retired on permanent and total disability and had taxable disability income in 2010.

Adjusted gross income may not exceed:

- Single, HOH, QW: $17,500.
- MFJ (one spouse eligible): $20,000.
- MFJ (both spouses eligible): $25,000.
- MFS (lived apart entire year): $12,500.

Note: Complete and attach *Credit for the Elderly or the Disabled* (Schedule R) to claim the credit on line 53. See Publications 524 and 554 for more information.

Other credits reported on line 53:

- Form 3800, *General Business Credit.*
- Form 8801, *Credit for Prior Year Minimum Tax*. See *Minimum Tax Credit* on Page 12-15.
- Form 8834, *Qualified Plug-In Electric Electric Vehicle Credit*. See *Credits for Plug-in Vehicles* on Page 11-7.
- Form 8910, *Alternative Motor Vehicle Credit*. See *Alternative Motor Vehicle Tax Credit* on Page 11-7.
- Form 8911, *Alternative Fuel Vehicle Refueling Property Credit.*
- Form 8912, *Credit to Holders of Tax Credit Bonds.*
- Form 8936, *Qualified Plug-In Electric Drive Motor Vehicle Credit.* See *Credits for Plug-in Vehicles* on Page 11-7.

Schedule B—Interest and Dividends starts on Page 5-22.

Schedule A—Itemized Deductions

Tab 5 Schedule A Topics

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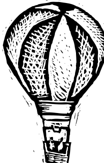
- *Auto Expenses*—Tab 11
- *Contributions: Noncash Donations*—Tab 3
- *Home Mortgages*—Tab 15
- *Sales Tax Deduction Worksheet*—Tab 3
- *Total Itemized Deductions Worksheet*—Tab 3
- *Travel Expenses*—Tab 9



Average Itemized Deductions—2008 Tax Returns

Adjusted Gross Income	Type of Deduction			
	Medical	Taxes	Interest	Charitable Contributions
$ 15,000 – 29,999	$ 7,074	$ 3,146	$ 9,245	$ 2,024
30,000 – 49,999	6,153	3,830	9,055	2,189
50,000 – 99,999	7,102	6,050	10,659	2,693
100,000 – 199,999	9,269	10,798	13,734	3,757
200,000 and over	28,558	38,090	24,543	15,754

Source: IRS 2008 Preliminary Data. The above averages are based on a return claiming a deduction for a particular category. For example, if no medical expenses are claimed on Schedule A, the zero amount does not reduce the overall average.

Limit on Itemized Deductions

Note: The AGI-based phase-out of itemized deductions does not apply for 2010. ~~However, it is scheduled to return in 2011.~~

Medical Deductions

See also IRS Pub. 502

Amount Deductible

Medical expenses in excess of 7.5%-of-AGI are deductible as itemized deductions. For alternative minimum tax (AMT), medical expenses must exceed 10%-of-AGI to be deducted. [IRC §56(b)(1)]

When to Deduct

Medical expenses are deductible in the year paid, regardless of when the expenses were incurred and regardless of the taxpayer's accounting method. [Reg. §1.213-1(a)]

Exceptions:

- *Credit card charge.* If paid with a credit card, the medical expense is deductible when charged, not when the credit card company is paid. (Rev. Rul. 78-39)
- *Decedents.* An election can be made to deduct medical expenses paid by a decedent's estate within one year after the date of death on the decedent's Form 1040, as if the expenses were paid when the medical services were provided. Thus, in some cases, an amended Form 1040 is filed. A statement must be attached to the decedent's Form 1040 or 1040X on which the expenses are deducted stating that the expenses will not be claimed as a deduction on the federal estate tax return. [Reg. §1.213-1(d)]

Medical Expenses Paid for Others

Deductible medical expenses include expenses paid for the taxpayer's spouse and for any person who qualifies as the taxpayer's dependent (for claiming an exemption), except that some of the tests required to claim an exemption do not have to be met to deduct an individual's medical expenses.

Dependents, for deducting medical expenses, must be U.S. citizens or nationals or residents of the U.S., Canada or Mexico and the taxpayer's:

- Child, foster child, stepchild, sibling, step-sibling and any of their descendants, if that person:
  - Is under age 19 (or under age 24 and a full-time student) or permanently and totally disabled,
  - Lived with the taxpayer for more than half the year and
  - Did not provide more than half of his own support for 2010.
- Child, stepchild, foster child, a descendant of any of them (for example, grandchild), sibling, niece, nephew, parent, grandparent, aunt, uncle, step-sibling, stepfather, stepmother, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law or any other person if that person lived as a member of the taxpayer's household all year (provided the relationship does not violate local law).
  - For whom the taxpayer provided more than one-half the support for the year.
- Former spouse, if the marriage existed either when the bills were incurred or at the time of payment.
- Adopted child before adoption, if child qualified as dependent when medical expenses were incurred or paid. After adoption is final, adopted child treated as the taxpayer's own child. Note that an adopted child does not have to be a U.S. citizen or national, or a resident of the U.S., Canada or Mexico if the parent claiming the medical expense deduction is a U.S. citizen or national with whom the adopted child lived as a member of the household during the year the medical expenses were paid.

Observation: Taxpayers can deduct medical expenses paid for some individuals who don't qualify for the dependency exemption, such as a parent for whom the taxpayer provides over half the support, even if the parent's income exceeds $3,650 (for 2010) [IRC §213(a)]. Likewise, medical expenses for a married child who

See *State and Local Sales Tax Deduction Worksheet (2010)* under *1040 Quickfinder® Handbook (2010 Tax Year)* in the Updates section of *Quickfinder.com*.

- *Imputed interest.* Part of the entrance fee to a life-care facility may be considered a loan if a portion of the payment is a long-term refundable fee. Certain taxpayers are exempt from the imputed interest rules on refundable fees treated as loans [IRC §7872(h)]. *Exemption qualifications:* The taxpayer (or spouse) must be age 62 or older, the facility must provide an independent living unit, along with an assisted living or nursing facility, or both, and substantially all of the independent living unit residents must be covered by continuing care contracts.

Insurance Reimbursements

Deductible medical costs must be reduced by any insurance reimbursements received. Excess reimbursements are taxable only to the extent they were provided for under an employer plan and were not included in income.

Taxes

See also IRS Pubs. 523, 530 and 535

Taxpayers have the option of claiming a Schedule A itemized deduction for either (1) state and local income taxes or (2) state and local general sales taxes.

State and Local Income Taxes

State and local income taxes are deductible on Schedule A in the year paid. The tax may be paid either through withholding, estimated payments or payments for prior year returns. The IRS may disallow deductions for large estimated state income tax payments made solely to increase itemized deductions (Rev. Rul. 82-208). The prepayment of estimated state income tax should be based on tax liability. Penalties and interest are not deductible.

Court Case: A taxpayer claimed the standard deduction rather than itemizing and deducted nonresident state income taxes from royalties on Schedule E. The court found that state income taxes are not expenses incurred in the production of royalty income. [*Strange*, 88 AFTR 2d 2001-6752 (9th Cir. 2001)]

State and Local General Sales Taxes

~~**Caution:** The special rule allowing taxpayers to deduct state and local sales taxes instead of state and local income taxes expired at the end of 2009 but, at the time of this publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Taxpayers who choose to deduct state and local sales taxes can deduct either:

1) Actual sales tax amounts (based on their records) or
2) Predetermined deduction figures from IRS tables.

To deduct actual amounts. Add up the nonbusiness general state and local sales taxes (including any compensating use taxes) paid during the year plus any selective sales taxes if the rate is the same as the general sales tax rate. Include selective sales taxes on food, clothing, medical supplies and motor vehicles even if the rate is lower than the general sales tax rate. If the selective sales tax rate on a motor vehicle is higher than the general rate, deduct only the amount that would have resulted from charging the lower general sales tax rate.

To deduct amounts from IRS tables. The table amounts depend on the taxpayer's AGI plus nontaxable income (for example, tax-exempt interest and nontaxable portion of Social Security benefits), the number of exemptions claimed on Form 1040 and the state of residence. If the taxpayer lives in more than one state during the year, pro-rate the amount from the table for each state (based on the number of days spent there divided by 365), add up the prorated amounts and deduct the total.

Note: In addition to the table amounts, the taxpayer can deduct additional actual sales tax amounts from purchases of motor vehicles (including leased vehicles). If the sales tax rate on a motor vehicle is higher than the general rate, deduct only the amount that would have resulted from charging the lower general sales tax rate. Also add sales taxes paid on boats, airplanes, homes (including mobile and prefabricated) or home building materials if the rate was the same as the general sales tax rate.

Note: ~~If Congress extends the deduction for state and local sales taxes to 2010 (see *Caution* in the previous column), the IRS tables taxpayers can use to compute the deduction will be posted to the Updates section of *Quickfinder.com*.~~

Real Estate Taxes

A real estate tax is deductible in the year it is paid to the taxing authority. Prepaid real estate taxes can generally be deducted in the year of the prepayment if the taxpayer is on the cash basis and does not live in an area in which the prepayment would be considered a deposit by the taxing authority. How prepaid taxes are treated varies among local jurisdictions. Taxes placed in escrow are deductible when actually paid to the taxing authority, not when paid to the escrow agent. Penalties and interest on late payments are not deductible.

Generally, real estate taxes can be deducted only by the owner of the property upon which the tax is imposed. Regulation Section 1.164-3(b) defines real property taxes as "taxes imposed on interests in real property and levied for the general public welfare…" Because of the lack of a detailed definition, the issue has been the subject of several court cases and IRS rulings. For example, the tax imposed on renters by the New York Real Property Tax Law is not deductible for federal tax purposes. Taxes paid under this law are considered rent, not property taxes. (Rev. Rul. 79-180)

In contrast, Revenue Ruling 71-49 stated that certain payments made to an educational construction fund by a cooperative housing corporation did qualify as real property taxes, and were deductible by the tenant-shareholders.

More than one property. Real estate taxes are deductible for all property owned by a taxpayer.

Sale of real estate. The buyer and the seller must divide real estate taxes according to the number of days that each owned the property during the year. Both are considered to have paid their share of taxes, even if one or the other paid the entire amount.

- *Buyer-paid taxes.* Deductible by the buyer only for the period he owned the property. The buyer cannot deduct the real estate taxes of the seller. The buyer must add these taxes to the basis of the property. The seller treats this as additional sales proceeds.
- *Seller-paid taxes.* If the seller pays real estate tax owed by the buyer (beginning on the date of sale), the buyer is considered to have paid the tax. The tax is deductible by the buyer. The buyer must reduce the basis in the home by the tax paid. The seller treats this as a reduced selling price.

Beneficial owner. Taxpayers who do not have legal title to their residence may still claim a Schedule A deduction for real estate taxes paid if they are equitable and beneficial owners of the property. An *equitable and beneficial owner* of property is someone who has exclusive burden and benefit of the property: he pays the mortgage payments, maintains the property and occupies the property exclusively. (*Njenge*, TC Summary Opinion 2008-84)

Cooperative Housing Corporations (Co-Ops)

Mortgage interest and property taxes allocated to a tenant-shareholder in a co-op are generally treated the same as those paid by other homeowners, provided the following conditions are met.

1) The corporation has only one class of stock outstanding,
2) Each shareholder has the right (but is not required) to occupy a dwelling unit solely because of the ownership of the stock,

Exchange students. Deduct up to $50 per school month for housing an exchange student (grade 12 or lower) sponsored by a qualified organization. The student does not have to be a foreign student as long as the student becomes a member of the taxpayer's household under a written agreement between the taxpayer and the charitable organization.

Foster parents. If there is no profit or profit motive, deduct expenses exceeding payments received from a charitable organization for providing support for qualified foster care individuals placed in the home.

Canadian, Mexican and Israeli charities. Donations to certain Canadian, Mexican and Israeli charities may be deductible under an income tax treaty with that country. Special rules or limits may apply. U.S. income tax treaties with these countries can be found on the IRS website.

Practice Tip: Certain donations for Haiti earthquake relief made after January 11, 2010 and before March 1, 2010 were deductible in 2009. If deducted in 2009, do not deduct in 2010.

Nondeductible Contributions

Money or property given to:

- Civic leagues, social and sports clubs, labor unions and chambers of commerce.
- Foreign organizations (other than certain Canadian, Mexican and Israeli charities).
- Groups that are run for personal profit.
- Groups whose purpose is to lobby for law changes.
- Homeowners' associations.
- Individuals.
- Political groups or candidates for public office.

Cost of raffle, bingo or lottery tickets.

Dues, fees or bills paid to country clubs, lodges, fraternal orders or similar groups.

Tuition (secular or religious).

Value of blood given to a blood bank.

Value of time or services rendered by the taxpayer.

Rental value of a timeshare donated to charity, such as the right to stay at it for one week. The ownership interest in the timeshare must be donated to charity to make the contribution deductible.

Charitable rollover from IRA. See *Qualified Charitable Distributions (QCDs)* on Page 14-13.

Limits on Charitable Contribution

The deduction for charitable contributions cannot exceed 50% of the taxpayer's AGI. A reduced limit of 30% or 20% applies for certain contributions.

Practice Tip: Most organizations know whether they qualify for the 50% limit. Also, IRS Pub. 78, *Cumulative List of Organizations*, which can be found at *www.irs.gov*, lists the limitation percentage for many charities.

Up to 50% of AGI limit. Donation of cash or property (other than capital gain property) to a publicly supported charity or foundation qualifying as a 50% limit organization.

Examples of 50% limit organizations: Churches, educational organizations, hospitals, medical research organizations, publicly supported organizations that receive a substantial amount of support from the general public or governmental units, private operating foundations, private nonoperating foundations that distribute 100% of the contributions to qualified charities within 2½ months after the end of the tax year, private foundations that pool contributions into a common fund and allow contributors to name the charities to receive their gifts if the income is distributed within 2½ months after the end of the tax year.

Up to 30% of AGI limit:

- Donation of capital gain property to a 50% limit organization. Property is *capital gain property* if its sale at FMV on the date of the contribution would have resulted in long-term capital gain. *Exception:* 30% limit does not apply if donor elects to deduct only the property's cost or other basis rather than its FMV.
- Donation of cash or property (other than capital gain property) to any qualified organizations other than 50% limit organizations (includes veterans' organizations, fraternal societies, nonprofit cemeteries, certain private nonoperating foundations).

Up to 20% of AGI limit. Donation of capital gain property to any qualified organizations other than 50% limit organizations. For multiple contributions subject to different limits, use the worksheet in IRS Pub. 526 to compute the deduction.

Qualified conservation contributions. The deduction for qualified conservation contributions is limited to 30% of AGI minus the deduction for all other charitable contributions. Any excess amount is carried forward 15 years.

Note: For ~~2009~~ 2010, qualified conservation contributions ~~were~~ are limited to 50% of AGI (100% of AGI for qualified farmers and ranchers). ~~At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Five-Year Contribution Carryforward

Contributions that exceed the AGI limit in the current year can be carried forward to each of the five succeeding years. Carryover contributions are subject to the original percentage limits in the carryover years, and are deducted after deducting allowable contributions for the current year. If there are carryovers from two or more years, use the earlier year carryover first.

Note: Contribution deductions disallowed due to NOL carryovers are added to the unused NOL as additional NOL and no longer treated as contributions [Reg. §1.170A-10(d)]

Standard deduction claimed. If the taxpayer claims the standard deduction in any of the carryover years (including the contribution year), the carryover amount is reduced by the amount that would have been deductible if itemizing. (Reg. §1.170A-10)

Deceased spouse. Carryovers allocable to the excess contributions of a deceased spouse may only be claimed on the final return of the deceased spouse, not by the surviving spouse. [Reg. §1.170A-10(d)(4)(iii)]

Contributions That Benefit the Taxpayer

Contributions that are made partly for goods or services provided by the organization are deductible if:

1) The amount of the payment exceeds the FMV of goods and services received, and
2) The donor intends to make a payment in excess of the FMV of goods and services.

> **Example:** Anita makes a large contribution to a charity that has a history of sponsoring a dinner-dance for donors making substantial contributions. The charitable deduction is limited to amount of the donation less the FMV of the anticipated dinner-dance even if the dance takes place in the following year.

Refused benefits. A donor can claim a full deduction if all benefits are actively refused (such as checking off a refusal box on a form sent by the charity). (Rev. Rul. 67-246)

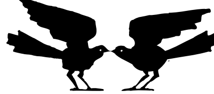
Gifts of more than $75. If the donor receives some benefit, the charity must provide a statement as to the deductible amount of the contribution. The charity must make a "good faith estimate" of the FMV of goods/services provided to the donor.

Token benefits. A donor can disregard benefits if either:

- The benefits received do not exceed the lesser of 2% of the contribution or $96 (for 2010) or

• Progressive deterioration.
• Termite or moth damage.

Deductible Casualty Losses



A casualty loss equals:

1) The lesser of:
   • Adjusted basis in the property before the casualty or theft, or
   • Decrease in FMV of the property as a result of the casualty or theft,
2) Minus any insurance or other reimbursement received or that is expected to be received.

Limits:

• *Personal-Use Property Deduction Limits* (Form 4684, Section A).
  – *$100 per casualty:* Reduction applies to each event that causes the casualty or theft. For example: a hailstorm damages the house, garage and car. There is only one $100 reduction, not three.

  ~~**Caution:** For 2009, the reduction amount for each casualty was $500 (rather than $100). At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

  – *10% of AGI:* Reduce the total of all casualty or theft losses on personal-use property by 10% of AGI. Apply this reduction after the $100 per casualty reduction.
• *Business and Income-Producing Property* (Form 4684, Section B). Losses on business property (including employee business-use property) and income-producing property are not subject to the $100 per casualty and 10%-of-AGI limits. If property was completely destroyed, the loss is generally the cost of the property minus accumulated depreciation. If property was damaged but not destroyed, the loss is generally the decrease in the property's FMV up to the adjusted basis.
• *Employee Business-Use Property.* Casualty losses on employee business-use property (property used in performing services as an employee) are miscellaneous itemized deductions subject to the 2%-of-AGI limitation.

Insurance reimbursement. Reduce the casualty loss amount by actual insurance reimbursement and by any expected reimbursement. If the property is covered by insurance, an insurance claim must be filed—otherwise, the casualty loss is not allowed. If the reimbursement exceeds the casualty amount (recovery is more than tax basis), the profit is currently taxable. *Exception:* If the insurance reimbursement is reinvested in similar property, tax is postponed until the replacement property is sold. See *Involuntary Conversions* on Page 7-14.

• *Time Limit.* Reinvestment must be made by the end of the second year following the insurance reimbursement. Taxpayers have four years to replace a main home in a federally declared disaster area.

Insurance reimbursement in following year. If a casualty loss is deducted in one year based on an expected insurance reimbursement, and the actual reimbursement in a following year turns out to be more or less than expected, an adjustment may be required.

• *More than expected.* If the reimbursement is more than expected, the excess amount is treated as ordinary income in the year received. *Exception:* The amount is not included in income to the extent the prior year's deduction did not reduce tax liability. (IRC §111)
• *Less than expected.* If the reimbursement is less than expected, the difference is treated as a casualty loss in the year the taxpayer can reasonably expect no more reimbursement. The prior year's tax return is not amended. The loss is combined with other casualty losses for that year. [Reg. §1.165-1(d)(2)]

Rule for real estate. Measure the decrease in FMV of the property and improvements as a whole, not as separate items.

Example: Elroy paid $150,000 for his home ($10,000 for the land and $140,000 for the house) and spent an additional $2,000 for landscaping. This year a fire destroyed his home and damaged the shrubbery and trees in the yard. An appraiser valued the property as a whole at $175,000 before the fire, but only $50,000 after the fire. Therefore, the starting point for determining Elroy's casualty loss deduction is $125,000.

Net operating loss. If the deductible casualty loss exceeds income, the casualty loss may create an NOL. See *Net Operating Loss (NOL)* on Page 6-14 for NOL rules.

Business Casualty Loss—Cost of Repairs

The IRS has issued legal advice to its agents that the cost of repairing damaged property or cleaning up after a casualty must be capitalized if the taxpayer takes a casualty loss deduction for that property (AM 2006-006). Often, the cost of repairing property is used as an estimate of the decline in the property's value due to the casualty (the amount of the casualty loss). However, the IRS says repair costs must be capitalized regardless of how the casualty loss deduction was computed.

Federally Declared Disasters

Taxpayers affected by a federally declared disaster are eligible for special tax relief provisions. See the table *Federally Declared Disasters—Quick Summary of Special Tax Relief Provisions* below for an overview.

Federally Declared Disasters—Quick Summary of Special Tax Relief Provisions

Item	Special Relief	IRC §
Casualty loss deduction	• 10%-of AGI limit waived.[1] • Can elect to claim losses in year before year of the disaster.	165(h)(3) 165(i)
Depreciation—50% bonus[1]	50% special (bonus) depreciation is allowed on *qualified disaster assistance property*[2] for the year it's placed in service. Such property is not subject to the AMT adjustment for its entire recovery period.	168(n)
Disaster expenses[1]	Certain disaster-related expenses paid in connection with a trade or business or business-related property are deductible, even though they are normally capitalized.	198A(a)
Disaster relief payments	Payments are nontaxable. See *Disaster relief payments* on Page 5-16.	139
Involuntary conversion—business or income-producing property	Any tangible replacement property acquired for use in *any* business is treated as similar or related in service or use to the destroyed property.	1033(h)(2)
Involuntary conversions—principal residence	• Replacement period is four years rather than two years. • Special rules for avoiding gain on receipt of insurance proceeds.	1033(h)(1)
Net operating loss (NOL) carryback[1]	NOL attributable to disaster loss may be carried back five years and fully deductible against AMT income.	172(b)(1)
Section 179 expense[1]	Deduction limit is increased by lesser of (a) $100,000 or (b) cost of qualified Section 179 disaster assistance property. Threshold for phaseout is increased by lesser of (a) $600,000 or (b) cost of qualified Section 179 disaster assistance property.	179(e)
Standard deduction[1]	Nonitemizers can increase their standard deduction by the amount of their disaster loss deduction.	63(c)(1)
Tax deadlines	Deadlines for filing and paying taxes and making IRS contributions are often postponed.	7508A

[1] **Caution:** For federally declared disasters declared after 2007 and occurring before 2010. ~~At the time of publication, Congress was considering legislation that would extend this provision to federally declared disasters occurring in 2010. See *Tax Extenders Legislation* on Page 17-1.~~

[2] Qualified disaster assistance property is replacement or rehabilitation property used in the same county and similar to the destroyed property, and includes tangible property with a MACRS recovery period of 20 years or less, computer software, qualified leasehold improvements, nonresidential real property and residential rental property. See Pub. 946 for additional requirements.

Starting a Business

See also Tab 7 for Sales of Business Property

Asset Acquisitions

Form 8594, *Asset Acquisition Statement Under Section 1060*, is filed by both the seller and the buyer of a group of assets that constitutes a trade or business. The purpose of the form is to identify and separate the value of goodwill and any other intangible assets from the value of tangible assets. Different depreciation and amortization rules apply to each group of assets. See *Asset Acquisitions* in Tab N of the *Small Business Quickfinder® Handbook* for more details.

Start-Up Costs of a New Business

Start-up costs are expenses connected with creating or investigating the creation or purchase of a trade or business. These expenses occur before the trade or business begins operations. Start-up costs must be capitalized because they are not incurred in carrying on a trade or business. (IRC §195)

Start-up costs include:

- Survey of potential markets.
- Advertising the opening of the business.
- Consulting or other professional fees paid in connection with starting the business.
- Wages to employees being trained for the new business.
- Analysis of possible facilities, labor force, supplies, etc.
- Travel and related expenses to secure distributors, suppliers and customers.

Deducting/amortizing start-up costs. Taxpayers can elect to deduct up to $10,000 (for 2010) of start-up costs and amortize the remainder over 180 months. A taxpayer is deemed to have made the election so an election statement attached to the return is not required (Temp. Reg. §1.195-1T). Instead, a statement is required only when the taxpayer wants to forgo the deemed election and capitalize start-up costs.

The $10,000 immediate deduction allowance is reduced dollar for dollar (but not below zero) by the taxpayer's cumulative start-up expenditures in excess of $60,000. Amounts that cannot be deducted currently (either because they exceed $10,000 or because of the $60,000 rule) are amortized over 180 months.

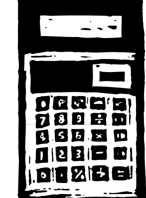
Amortization of start-up costs is reported on Part VI of Form 4562 and the deduction is carried to the "other expenses" line on Schedule C (or F).

Net Operating Loss (NOL)

See also IRC §172, IRS Pub. 536, and Tab 3 for NOL Worksheets

When business deductions exceed business income, an NOL may occur. An NOL may be caused by deductions from a trade or business, from working as an employee, or from casualty and theft losses, moving expenses or rental property.

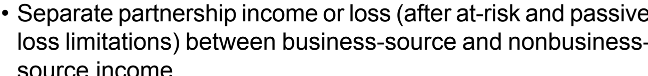
Calculating an NOL



1) *Complete the tax return.* Adjusted gross income minus the standard or itemized deductions (line 41 of 2010 Form 1040) must be less than zero to have a potential NOL.
2) *Separate business and nonbusiness income and deductions.* An NOL must be caused by losses or deductions from business sources (as defined for NOLs). Use *Net Operating Loss Worksheet #1* on Page 3-10 to determine business/nonbusiness income and deductions.

Determine business/nonbusiness source:

- Pro-rate state and local income taxes between business-source and nonbusiness-source income.
- Rental real estate activities (portion recognized after passive loss limitations) are considered business-source income or loss.



- Separate partnership income or loss (after at-risk and passive loss limitations) between business-source and nonbusiness-source income.
- Royalties shown on Schedule C are business-source income; royalties shown on Schedule E are nonbusiness income.
- Casualty and theft losses are business deductions even if they involve nonbusiness property.

3) *Separate business/nonbusiness capital gains and losses.* In general, a net capital loss is not included in an NOL. However, business and nonbusiness capital transactions still must be separated and used in the NOL calculation. The holding period is not considered for NOL purposes.
   - *Business Capital Transactions.* Sale of goodwill or patent rights and the sale of business assets that receive capital gain or loss treatment under Section 1231.
   - *Nonbusiness Capital Transactions.* Sale of stock and other investment property.
4) *Compute current year NOL.* In general, NOL rules do not allow personal exemptions, net capital losses, nonbusiness losses, nonbusiness deductions or NOLs from other years. Use *Net Operating Loss Worksheet #2—Computation of NOL* on Page 3-11 (or Form 1045, Schedule A) to make the necessary adjustments.
   - Nonbusiness deductions are deductible to the extent of nonbusiness income plus nonbusiness net capital gain.
   - Nonbusiness capital losses are deductible to the extent of nonbusiness capital gains.
   - The Section 199 domestic producer deduction is not allowed when computing an NOL.

   If the adjustments on Worksheet #2 result in a negative amount, an NOL exists.

Using a Current-Year NOL

An NOL generally is carried back two years and then forward 20 years. Special rules apply to certain types of losses.

Carryback Rules for 2010 NOLs				
Carryback	**5 Years**	**3 Years**	**2 Years**	**Elect Out**
NOL	N/A	N/A	Automatic	May elect
Eligible loss	N/A	Automatic	N/A	May elect
Farming loss	Automatic	N/A	May elect	May elect
Qualified disaster loss	Automatic	N/A	May elect	May elect

Eligible loss. The portion of an NOL that is (1) a personal casualty loss or (2) for small businesses or farmers, attributable to a federally declared disaster. An eligible loss does not include a farm loss or qualified disaster loss (as defined below).

Farming loss. The NOL computed by considering only farming income and deductions (or the NOL for the year, if smaller). Do not include any qualified disaster loss (as defined below).

Qualified disaster loss. The lesser of the NOL or the casualty loss attributable to a federally declared disaster declared after 2007 and occurring before 2010, plus the deduction for qualified disaster expenses. ~~**Caution:** At the time of publication, Congress was~~

~~considering legislation that would extend this provision to disasters occuring in 2010. See *Tax Extenders Legislation* on Page 17-1. Also see *Federally Declared Disasters* on Page 5-15.~~

Available elections. The following elections are irrevocable and must be made on a timely filed return (including extensions) for the NOL year.

- *Election to Waive the Carryback Period.* Taxpayers may elect to waive the carryback years and only use the NOL in the 20-year carryforward period. Attach the following statement to the return: "The taxpayer elects to waive the entire NOL carryback period under Section 172(b)(3) of the Internal Revenue Code."
- *Election to Disregard Five-Year Carryback Treatment.* Taxpayers with a loss eligible for a five-year carryback may elect to treat the loss as if it was regular NOL and use a two-year carryback period. Attach the following statement to the return: "The taxpayer elects to treat any 2010 (specify type of loss, such as farming loss, qualified disaster loss, etc.) without regard to the special five-year carryback rule."

Observation: Taxpayers could elect a two-, three-, four- or five-year carryback period for either the 2008 or 2009 NOL (or in some cases, both the 2008 and 2009 NOL) [IRC §172(b)(1)(H)]. See the 2009 Pub. 536 for details.

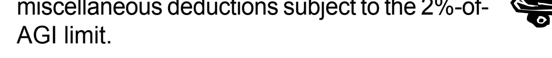
Deducting a Carryback

To claim a refund from an NOL deduction, file either:

- *Form 1045.* May be used to apply an NOL to all available carryback years. It must be filed not later than one year after the close of NOL year.
- *Form 1040X.* Must use a separate 1040X for each carryback year to which the NOL is applied. Must file within three years after the due date (including extensions) for filing the return for the NOL year. Check the box next to line 1 and write "Carryback Claim" at the top of page 1 of the Form 1040X.

Decrease in tax computation. To calculate the decrease in tax for a carryback year, refigure the following, taking into account a refigured AGI that includes the NOL:

- Special allowance for passive losses from rental real estate activity.
- Taxable Social Security or tier 1 railroad retirement benefits.
- IRA deduction.
- Student loan interest deduction.
- Tuition and fees deduction.
- Excludable savings bond interest.
- Excludable employer-provided adoption benefits.
- Medical, casualty and theft losses, as well as miscellaneous deductions subject to the 2%-of-AGI limit.



- Phaseouts for itemized deductions and personal exemptions.
- Tax credits that are based on or limited by the amount of tax.
- Other taxes (such as alternative minimum tax).

Do not refigure charitable contributions in an NOL carryback year.

Self-employment tax. An NOL does not change the SE tax of any years to which it is carried forward or back.

Interest and penalties. An NOL carryback to a year with a tax deficiency will only reduce tax. An NOL carryback will not reduce interest or penalties in the carryback year.

Calculating how much NOL is used. If the NOL is not fully absorbed in a year to which it is carried, modifications are made to income for that year to determine how much of the unused NOL is available for the following year. Use *Net Operating Loss Worksheet #3—NOL Carryback* on Page 3-11 (or Form 1045, Schedule B) to make this computation. Modifications are made for:

- *Nondeductible items.* The NOL carried to such year plus all future NOLs carried to such year, net capital losses, any Section 1202 exclusion, domestic production activities deduction and personal exemptions (prior-year NOLs carried forward are deductible).
- *Refigure deductions due to change in AGI.* After adding back the nondeductible items above, refigure items based on AGI, such as the items listed at Decrease in tax computation in the previous column. Also recompute the charitable contribution deduction, but do not include NOL carryback deductions.

Note: Recomputed AGI and refigured deductions are only used for determining how much of the NOL is left to carry forward. This step does not recalculate the actual tax liability for the carryback or carryforward year.

Net operating loss carryforward. For NOLs carried forward to a tax year after the NOL year, the NOL is shown as a negative amount on the other income line of Form 1040 (line 21 for 2010).

Schedule SE—Self-Employment Tax

See also IRS Pub. 334

Also refer to:

- *Farming Income and SE Tax*—Page 6-17
- *Section 179 Recapture*—Page 10-11
- *Ministers/Clergy*—Page 12-18

Self-employment tax computed on Schedule SE applies to sole proprietors (Schedules C and F) and general partners of a partnership (Schedule K-1, Form 1065).

Tax rate for 2010. SE tax = net SE earnings × 15.3%, on net SE earnings up to $106,800 plus 2.9% × net SE earnings over $106,800. For this purpose, *net SE earnings* are the net profit from all trades and businesses multiplied by 92.35%. Net SE earnings are combined with any FICA wages earned as an employee for determining when the $106,800 limit is met.

Health insurance premiums. For 2010, premiums a self-employed person deducts for income tax reduce the net profit from the business when computing SE tax. See *Self-employed health insurance deduction* on Page 6-6.

Who must file schedule SE. In general, any individual who carries on a *trade or business* must file Schedule SE if net earnings from all trades or businesses are $433.13 or more ($433.13 × 0.9235 = $400).

Trade or business. An activity carried on for a livelihood or in good faith to make a profit. A taxpayer does not actually have to make a profit to be a trade or business as long as there is a motive for making a profit. The activity does not have to be a regular full-time job to be subject to SE tax.

Statutory employees. See *Statutory Employees* on Page 6-13.

Automobile salespersons. An incentive payment made by an automotive manufacturer to a retail automobile salesperson is reported as "Other Income" on line 21 of the 2010 Form 1040. Such a payment is not subject to employment taxes or SE tax, whether paid directly to the individual or through the dealer. Expenses associated with the payment are reported as miscellaneous itemized deductions subject to the 2%-of-AGI limit. (Rev. Rul. 70-337; IRS Pub. 3204)

Business interruption insurance. Proceeds are subject to SE tax, unless paid because the business is liquidated. (Rev. Rul. 91-19)

Termination payments to former insurance agents working as independent contractors are excluded from SE tax if: [IRC §1402(k)]

1) The amount is received after termination of the agent's agreement to perform services for the company,
2) The agent does not perform any services for the company after termination and before the close of the tax year,

Continued on the next page

Business Use of Vehicles—75% Rule

Farmers can claim 75% business use for vehicles used primarily for farming business instead of keeping records of business mileage. [Reg. §1.274-6T(b)]

Once this method is elected, it must be used in future years. Likewise, if the standard mileage rate or actual expenses method is elected, the farmer cannot revert to the 75% rule.

Conservation Expenses

A farmer may elect to deduct or capitalize expenses for soil and water conservation or to prevent farmland erosion (IRC §175). The election must be made in the first year that the farmer pays or incurs such expenditures, and is binding for all subsequent years. Conservation expenses must be allocated if they benefit both land used for farming and land that does not qualify.

Deductible conservation expenses. Water and soil conservation expenses are deductible for land used currently or in the past for farming by the farmer or the farmer's tenant. Water and soil conservation expenses may be deductible if they are consistent with a plan approved by the USDA's Soil Conservation Service or a comparable state agency. The deduction cannot exceed 25% of gross income from farming. Deductions not allowed in the current year may be carried forward to following years, subject to the 25% limitation. Deductible conservation expenses include:

- Treatment or movement of earth (grading, leveling, terracing, conditioning, contour furrowing, restoration of fertility).
- Eradication of brush.
- Planting windbreaks.
- Construction, control and protection of irrigation and drainage ditches, diversion channels, earthen dams, outlets, ponds.

Notes:

– Expenses to drain or fill wetlands are not deductible.

– Expenses to maintain completed soil and water conservation structures (for example, the removal of drainage ditch sediment) are deductible farm business expenses.

Depreciable conservation expenses. Expenses for nonearthen items of masonry or concrete must be capitalized. *Exception:* Part of an assessment for depreciable property levied against a farm by a soil and water conservation or drainage district may be deductible. *Depreciable conservation expenses include:* Materials, supplies, wages, fuel, hauling and moving dirt for structures or facilities such as tanks, reservoirs, pipes, conduits, canals, dams, wells or pumps made of masonry, concrete, tile, metal or wood.

Land clearing versus soil and water conservation. Land clearing prepares the land for farming, while soil and water conservation preserves the quality of land being farmed. Expenses for land clearing are added to the basis of the land and are not deductible. Land clearing expenses include:

- Cutting trees, blasting stumps, burning residual undergrowth.
- Leveling land for planting or irrigation.
- Removing minerals such as salt from the soil.
- Diverting a stream to another watercourse.
- Draining and filling a swamp or marsh.

Section 179 Deduction—Farm Property

See *Section 179 Deduction* on Page 10-9 for general rules. Also see *Section 179 Limit for SUVs* on Page 11-3.

Farm property that qualifies for a Section 179 deduction includes:

- Tangible personal property such as machinery and equipment, milk tanks, automatic feeders, barn cleaners and office equipment.
- Livestock (horses, cattle, hogs, sheep, goats and mink and other fur bearing animals).
- Single-purpose agricultural and horticultural structures.

Single-purpose agricultural structure. Building or enclosure specifically designed, constructed and used for: housing, raising and feeding a particular type of livestock (including poultry but not horses), their produce and the equipment necessary for feeding and caring [IRC §168(i)(13)]. This includes structures used to:

- Breed chickens or hogs.
- Produce milk from dairy cattle.
- Produce feeder cattle or pigs, broiler chickens or eggs.

Single-purpose horticultural structure:

1) A greenhouse specifically designed, constructed and used for the commercial production of plants or
2) A structure specifically designed, constructed and used for commercial mushroom production.

Depreciating Farm Assets

Three-, five-, seven- and 10-year MACRS property used in a farming business must be depreciated using the 150% declining-balance or straight-line method. See *MACRS Recovery Periods (2010)* on Page 10-2.

Farm equipment. New machinery or equipment used in a farming business and placed in service during 2009 is depreciated over five years [IRC §168(e)(3)]. If the alternative depreciation system (ADS) is required or elected, the property is assigned a 10-year recovery period. *Exception:* The five-year recovery period does not apply to fences, land improvements, grain bins or cotton ginning assets.

~~**Note:** At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Estimated Tax

No penalty for failing to make estimated tax payments for 2010 if at least two-thirds of total gross income was from farming or fishing during 2010 or 2009 and Form 1040 is filed and all the tax due is paid by March 1, 2011. See also *Underpayment/Estimated Tax Penalty* on Page 16-5.

If a farmer or fisherman must pay 2010 estimated tax, only one annual payment is required by January 18, 2011, using special rules to figure the amount of the payment. See Pub. 225 for details.

Farming gross income. Determine if at least two-thirds of total gross income is from farming or fishing as follows.

Gross income from farming includes:

- Gross farm income from Schedule F.
- Gross farm rental income from Form 4835.
- Gross farm income from Schedule E, Parts II and III.
- Gains from the sale of livestock used for draft, breeding, sport or dairy purposes reported on Form 4797.

Gross income from farming does not include:

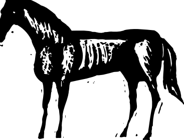
- Wages received as a farm employee.
- Gains from sales of farmland and depreciable farm equipment.
- Income received from contract grain harvesting and hauling with workers and machines furnished by the taxpayer.

Form T (Timber)—Forest Activities Schedule

Generally, Form T should be filed when standing timber is sold or cut, or when there are other timber transactions.

Form T must be completed to claim a deduction for timber depletion, to elect to treat the cutting of timber as a sale or exchange under Section 631(a), or to report outright sales of timber under Section 631(b).

Note: For more information about the taxation of timber, see *Forest Landowners' Guide to the Federal Income Tax*, available at *www.fs.fed.us/publications*.



Sale or exchange of timber:

- *Timber sold primarily for sale to customer.* Gain or loss is treated as ordinary income subject to SE tax. Farmers who cut and sell timber on their land in the form of logs, firewood or pulpwood report income and expenses as ordinary income and expenses on Schedule F.
- *Standing timber sold from investment property.* Treated as a capital gain or loss, reported on Schedule D.
- *Outright sales of timber.* Outright sales of timber by landowners qualify for capital gains treatment if the timber was held for more than one year before the date of disposal.

Generally, cutting of timber results in no gain or loss until sold or exchanged. *Exception:* Under Section 631(a) taxpayers can elect to treat the cutting of timber as a sale under Section 1231 in the year it is cut. To qualify for the Section 631(a) election, the timber must be cut for sale or for use in the taxpayer's trade or business, and the taxpayer must own or hold a right to cut timber for more than one year before the timber is cut.

Timber depletion. The depletion deduction for timber must be calculated using cost depletion. The depletion is taken in the year of sale or other disposition of the products cut from the timber, unless the taxpayer elects to treat the cutting of timber as a sale or exchange. The depletion deduction is limited by the adjusted basis of the timber. The adjusted basis for depletion cannot include the residual value of land and improvements at the end of operations. [Reg. §1.612-1(b)(1)]

> **Example:** Samuel purchases a timber tract for $160,000. The residual value of the land at the time of purchase, assuming all timber has been cut, equals $100,000. The depletable basis of the timber for cost depletion is $60,000 ($160,000 – $100,000). Samuel determines that the standing timber will produce 1,000 units when cut. Samuel's depletion per unit equals $60 ($60,000 ÷ 1,000). If Samuel sold 300 units during the year, his depletion allowance would be $18,000 (300 × $60).

Domestic Producer Deduction (DPD)

Form 8903

For 2010, the DPD is 9% of the lesser of the business's:

1) Qualified production activities income or
2) Taxable income (AGI for individual taxpayers) determined without regard to the DPD.

The DPD cannot exceed 50% of the wages paid and reported on Form W-2 by the business for the year (and allocable to domestic production gross receipts).

Oil and gas activities. Starting in 2010, individuals with oil-related qualified production activities income must reduce their DPD by 3% of the least of their (1) oil-related qualified production activities income, (2) qualified production activities income or (3) AGI (determined without regard to the DPD). [IRC §199(d)(9)]

Oil-related qualified production activities income is qualified production activities income attributable to the production, refining, processing, transportation or distribution of oil, gas or any primary product thereof.

Qualified Production Activities Income

To determine the net income that qualifies for the 9% deduction, the taxpayer's receipts must be divided into those from eligible activities (domestic production gross receipts, or DPGR) and non-DPGR. Then, the taxpayer's expenses are allocated between the two categories of income. The DPGR less allocable expenses equals qualified production activities income.

Eligible activities. The following activities generate DPGR if performed in the U.S.: [IRC §199(c)(4)]

- Manufacture, production, growth or extraction of:
  - Tangible personal property (for example, clothing, goods, food, agricultural products).
  - Computer software.
  - Sound recordings.
- Certain film production.
- Production of electricity, natural gas or potable water.
- Construction or substantial renovation of residential and commercial buildings and infrastructure by taxpayers engaged in the construction business.
- Engineering and architectural services performed by a taxpayer engaged in the business of performing engineering or architecture.

Observation: While most U.S. farming activities will generate DPGR, income from custom farming if the farmer does not have the benefits and burden of ownership of the property is not DPGR.

Caution: For 2006–~~2009~~ 2011, qualified production activities performed in Puerto Rico ~~were~~ are included in the domestic production gross receipts calculation as long as the activity in Puerto Rico ~~was~~ is subject to U.S. tax. ~~At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Allocating costs. There are three methods for allocating costs to DPGR (that is, income that qualifies for the DPD) and non-DPGR. [Reg. §1.199-4]

Small business simplified overall method. Allocate all deductions (including cost of goods sold) and losses between DPGR and non-DPGR based on relative gross receipts. Available to:

- Taxpayers with average gross receipts under $5 million.
- Taxpayers with average gross receipts of $10 million or less, if they qualify to use the cash method under Revenue Procedure 2002-28.
- Farmers not required to use the accrual method.

Simplified deduction method. Use gross receipts to allocate all costs and expenses except cost of goods sold. Cost of goods sold must be specifically traced to DPGR and non-DPGR. Available to taxpayers with average annual gross receipts of $100 million or less or total assets of $10 million or less at the end of the year.

Section 861 Method. Deductions are allocated to DPGR using the rules under Section 861 for allocating deductions to foreign income. This is the most complex method because it requires tracing each cost to income.

S corporations and partnerships. The DPD is determined at the shareholder or partner level so taxpayers should get the information from the partnership or S corporation Schedule K-1. Enter that information on Lines 7 and 17 of Form 8903.

—End of Tab 6—

Schedule D; Form 4797; Sales and Exchanges

Tab 7 Topics

Real Estate Comparison Chart .... Page 7-2
Settlement Costs on Sale or Purchase of Real Estate .... Page 7-3
Schedule D—General Rules .... Page 7-3
Stocks and Other Securities .... Page 7-5
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Employee Stock Options .... Page 7-9
Bad Debts .... Page 7-10
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Installment Sales .... Page 7-11
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Reduced Exclusion Rules .... Page 7-18
Business or Rental Use of Home .... Page 7-19
Foreclosures .... Page 7-20
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Where to Report Gains and Losses

Property Sold	Sold at a Gain	Sold at a Loss
Depreciable trade or business property[1]—Held one year or less[2]	Form 4797, Part II	Form 4797, Part II
Depreciable trade or business property[1]—Held more than one year[2]	Form 4797, Part III	Form 4797, Part I
Capital asset—Held one year or less	Schedule D, Part I	Schedule D, Part I
Capital asset—Held more than one year	Schedule D, Part II	Schedule D, Part II
Ordinary-income property (for example, inventory)	Schedule C	Schedule C
Personal-use property—Held one year or less	Schedule D, Part I	Nondeductible; do not report[3]
Personal-use property—Held more than one year	Schedule D, Part II	Nondeductible; do not report[3]

[1] Also depreciable residential rental property.
[2] For cattle and horses, substitute "24 months" for "one year."
[3] Report on Schedule D only if personal-use real property for which Form 1099-S is received (but show -0- in column f).

Capital Gain and Dividend Tax Rates—2010

	Holding Period	Ordinary Tax Rate Bracket					
		10%	15%	25%	28%	33%	35%
Capital Gains							
Short-term	≤ 1 year	10%	15%	25%	28%	33%	35%
Long-term	> 1 year	0%	0%	15%	15%	15%	15%
Unrecaptured Section 1250	> 1 year	10%	15%	25%	25%	25%	25%
Collectibles	> 1 year	10%	15%	25%	28%	28%	28%
Qualified Section 1202[1]	> 5 years	10%	15%	25%	28%	28%	28%
Dividends							
Qualified	> 60 days[2]	0%	0%	15%	15%	15%	15%
Other	≤ 60 days[2]	10%	15%	25%	28%	33%	35%

[1] 50% (60% for certain empowerment zone business stock) of the gain is excluded so the maximum effective rate is 14%.
[2] 90 days in the case of preferred stock.

Basis for Computing Gain or Loss

See also IRS Pub. 551

Type of Acquisition	Basis for Gains or Losses	Holding Period Begins
Purchase	Purchase price *plus* acquisition and installation charges.	On day after the date of acquisition.
Gift property: Sold at a GAIN[1]	Donor's basis.	On date donor's holding period began.
Gift property: Sold at a LOSS[1]	*Lesser of:* Donor's basis or	On date donor's holding period began.
	Property FMV at time of gift.	On day after date of gift.
Inherited property	FMV on date of decedent's death.[2]	Automatically long-term[3]
Taxable exchange	FMV at time of exchange.	On day after the date of acquisition.
Like-kind exchange	Basis of old property traded in plus any boot paid.	On day after the date the old property was acquired.
Property converted from personal to business use	Basis for gain is cost. Basis for loss and depreciation is lesser of cost or FMV at time of conversion.	On day after the date of acquisition.
Property repossessed by seller	Adjusted basis of the debt due, plus gain from the repossession, plus any repossession expenses.	On day after date property originally acquired, but doesn't include time between sale and repossession.

Note: Basis is increased by improvements, additions, capital contributions, litigation expenses, etc., but not by appreciation. Basis is decreased by tax benefits such as a return of capital, depreciation (or depletion), tax credits, etc.

[1] Gifted property:
- Basis for depreciation is always the donor's adjusted basis.
- Basis is adjusted if gift tax has been paid.
- Basis of gifts between spouses is always the donor's adjusted basis.

[2] See *Basis of Inherited Property* on Page 15-5 for special rules for jointly-owed property and property inherited from decedents who died in 2010.

[3] Inherited property is always long term [IRC §1223(9)]. On Schedule D, list "Inherited" instead of the date of acquisition. **Note:** Automatic long-term holding period does not apply to property inherited from decedents who died in 2010 if the executor elected carryover basis rule.

Borrower's Foreclosure Worksheet[1]

Part 1. Income from cancellation of debt.

Note: If the taxpayer is not personally liable for the debt, there is no income from debt cancellation. Skip Part 1 and go to Part 2.

1) Enter the amount of debt canceled by the transfer of property .... 1) $________
2) Enter the FMV of the transferred property.............................. 2) <________>
3) Income from cancellation of debt.[2] Subtract line 2 from line 1. If less than zero, enter -0-.............................. 3) $________

Part 2. Gain or loss from foreclosure or repossession.

4) Enter the smaller of line 1 or line 2. Also include any proceeds received from the foreclosure sale. (If the taxpayer is not personally liable for the debt, enter the amount of debt canceled by the transfer of property.)............ 4) $________
5) Enter the adjusted basis of the transferred property .... 5) <________>
6) Gain or loss from foreclosure or repossession. Subtract line 5 from line 4.............................. 6) $________

[1] See *Foreclosures* on Page 7-20.
[2] This income may not be taxable. See *Report COD income* on Page 7-21.

Basis/Adjusted Basis

The method of acquisition determines the original basis of the home. If purchased or built, the basis is its cost. If acquired by some other method, such as inheritance, gift or a divorce property settlement, basis is either the FMV when received or the adjusted basis of the person from whom it was received. See the *Basis for Computing Gain or Loss* chart on Page 7-1.

Once the original basis is determined, certain adjustments must be made throughout the period of ownership.

Increases to basis generally include:

- Cost of additions and other improvements that have a useful life of more than one year.
- Special assessments for local improvements.
- Amounts spent after a casualty to restore damaged property.

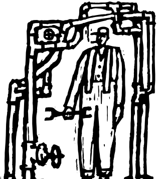
Decreases to basis generally include:

- Discharge of qualified principal residence indebtedness that was excluded from income (but not below zero).
- Residential energy credits if the cost of the energy item was added to basis.
- If the taxpayer filed Form 2119 in the year the current home was originally acquired to postpone gain on the sale of a previous home that was sold before May 7, 1997, the amount postponed decreases basis in the current home.
- Deductible casualty losses.
- Insurance payments received or expected to be received for casualty losses.
- Payments received for granting an easement or right-of-way.
- Depreciation allowed or allowable if the home was used for business or rental purposes.
- Adoption credit claimed for improvements added to the basis of the home.
- Nontaxable payments from an adoption assistance program of an employer that were used for improvements added to the basis of the home.
- District of Columbia first-time homebuyers credit.
- Energy conservation subsidy excluded from gross income because the subsidy was received (directly or indirectly) from a public utility after 1992 to buy or install any energy conservation measure. An energy conservation measure is an installation or modification that is primarily designed either to reduce consumption of electricity or natural gas or to improve the management of energy demand for a home.

Recordkeeping. Although the Section 121 exclusion rules may seem to eliminate the need to keep records, there are still many reasons to keep track of the basis in a home. For example, taxpayers may have gains in excess of the exclusion amount because of a change in filing status due to death or divorce that reduced the amount of the available exclusion. Also, taxpayers who have business or rental use of their home will need adequate records to compute the exclusion amount and taxable gain upon sale of the home as well as depreciable basis.

Fixing-Up Expenses

The treatment of fixing-up expenses depends on whether they are considered improvements or repairs.



Improvements. These add to the value of the home, prolong its useful life or adapt it to new uses. Add the cost of additions and other improvements to the basis of the home. For example, new recreation room, bathroom, fence, plumbing or wiring, new roof, paved driveway, deck, sunroom or garage.

Repairs. These costs maintain the home in good condition but do not add to its value or prolong its life. These costs are non-deductible and are not added to the basis of the property. For example, repainting the house inside or outside, fixing the gutters or floors, repairing leaks or plastering and replacing broken window panes.

Inherited Houses

- The basis of an inherited house equals FMV at the time of decedent's death, or the alternate valuation date, if used. *Exception:* In certain situations, property inherited from a person who died in 2010 will have carryover basis rather than basis equal to FMV at the time of death. See *Basis of Inherited Property* on Page 15-5.

  Caution: When jointly owned property is inherited, only the basis in the portion of the property included in the decedent's gross estate is adjusted to FMV. *Exception:* For community property, surviving spouses also adjust the basis of their half interest in the property. See *Community property* on Page 15-6. The nine community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin.
- Inherited property is always considered to have been held long term. *Exception:* Property inherited from a decedent who died in 2010 ~~generally~~ has a tacked holding period beginning when the decedent acquired the property. if executor elected carryover basis
- Loss from the sale of an inherited house is generally a capital loss. However, if the inherited house was changed to business use before the sale, the loss would be deductible as an ordinary loss. For example, if an inherited house was rented and subsequently sold, the entire loss may qualify as a deductible ordinary loss on the sale of business-use property.

  Caution: Offering the house for rent before sale does not automatically satisfy the change to business-use requirement. The IRS determination as to whether property is used for business is made on a case-by-case basis, with the taxpayer's intent being an important factor.
- If the beneficiary uses the inherited house for personal purposes, any loss from the sale would not be allowed.

Sale of Residence

See also IRS Pubs. 523 and 530

Sale of Residence Reporting Rules

The sale of a principal residence is generally not reported on a taxpayer's return unless the taxpayer:

- Has a gain and does not qualify to exclude it all.
- Has a gain and elects not to exclude it.
- Has a loss and receives a Form 1099-S.

See *Residence Gain Exclusion* below for details on gain exclusion. See *Reporting the Sale* below for how to report any gain that is not excluded.

Caution: Taxpayers who claimed the first-time homebuyer credit and who sell the residence in 2010 may have to repay all or part of the credit in 2010. See *First-Time Homebuyer's Credit* on Page 12-10 for more information.

Form 1099-S. Generally, real estate agents, title companies, lawyers, etc., responsible for closing the transaction are required to issue Form 1099-S to the seller of real estate. An exception applies for the sale of a principal residence for $250,000 or less ($500,000 or less MFJ or certain surviving spouses) if the real estate reporting person obtains written certification from the seller. The certification must include information to support the conclusion that the full gain on the sale is excludable from the seller's income. If there are joint sellers, each seller (whether married or not) must make written certification for the exception to apply. (Rev. Proc. 2007-12)

Reimbursements

When an employer reimburses an employee for travel, meals or entertainment expenses, the reimbursement is excluded from the employee's income if the reimbursement arrangement is an accountable plan. Similar rules apply to independent contractors [Reg. §1.274-5T(h)(2)]. Employees cannot deduct meals and entertainment expenses if the employer reimburses the expenses under an accountable plan and does not treat the reimbursement as wages. See *Accountable Plan/Nonaccountable Plan* below.

Independent contractors cannot deduct meals and entertainment expenses if the customer or client makes direct reimbursement for the expenses and adequate records are submitted to the customer or client. See *Elements to Prove Certain Business Expenses* on Page 9-6.

Note: If reimbursements for meals are excluded from the income of the employee or independent contractor, the employer (or customer/client) is generally subject to the 50% deduction limit. See *50% Limit* on Page 9-2.

Failure to claim reimbursement. Employees may not deduct business expenses that are eligible for reimbursement from the employer.

Accountable Plan/Nonaccountable Plan

Accountable plan. Reimbursements made to an employee under an accountable plan are not included in the employee's income, and the employee does not deduct the expenses.

Nonaccountable plan. Reimbursements made to an employee under a nonaccountable plan are treated as taxable wages and reported in box 1 of Form W-2. The employee deducts the expenses on Form 2106, subject to the 2%-of-AGI limitation on Schedule A.

An employee who receives payments under a nonaccountable plan cannot convert the payments to an accountable plan by voluntarily accounting to the employer or returning excess payment.

Accountable plan requirements: [IRC §62(c)]

1) *Business Connection.* The reimbursement must be for job-related expenses the employee would reasonably be expected to incur. A plan that reimburses personal expenses does not qualify as an accountable plan.
2) *Substantiation.* The employee must substantiate the expense by providing receipts or other documentation to the employer within a reasonable period of time.
3) *Return of Excess Reimbursement.* The employee must be required to return any excess reimbursement to the employer within a reasonable period of time.

Reasonable period of time. The following situations will be considered within a reasonable period of time for purposes of accountable plans.

1) The employee receives an advance within 30 days of the time the expense is incurred.
2) The employee adequately accounts for the expense within 60 days of the time the expense was paid or incurred.
3) Any excess reimbursement is returned to the employer within 120 days after the expense was paid or incurred.
4) The employer provides a statement to the employee (at least quarterly) asking the employee to either return or adequately account for outstanding advances, and the employee complies within 120 days of the statement.

If the above requirements are not met, the plan is considered a nonaccountable plan.

Part accountable plan or part nonaccountable plan. If an employer makes reimbursements to an employee under an accountable plan, but some reimbursements do not qualify under accountable plan rules, only the reimbursements falling under the nonaccountable plan are considered taxable wages. Each plan is viewed separately, and the employer treats the employee as having received reimbursements under two different plans.

Above-the-Line Deduction for Certain Employees

Government officials paid on a fee basis, qualified performing artists, Armed Forces reservists and educators can claim business expenses as an adjustment to income. [IRC §62(a)(2) and 162]

Government fee basis officials (FBOs). Individuals who are employed by a state or local government and paid in whole or in part on a fee basis.

Qualified performing artists (QPAs):

1) Perform services as an employee in performing arts for at least two employers during the tax year and receive at least $200 from any two of the employers,
2) Incur performing arts-related business expenses of more than 10% of the gross income from performing arts and
3) Have AGI of $16,000 or less before deducting performing arts expenses. To qualify, married individuals must file a joint return unless they lived apart for all of the tax year.

Armed Forces reservists. National Guard members and Armed Forces reservists who must travel more than 100 miles away from home and stay overnight to fulfill their training and service commitments can claim an above-the-line deduction for the cost of transportation, meals (subject to the 50% disallowance rule) and lodging. The deductible amounts are limited to general federal government per diem amounts for the applicable locale.

Method of reporting. Form 2106 is completed to report eligible expenses for FBOs, QPAs and reservists. The expenses are then entered on line 24 of Form 1040.

Educators. Grades K–12 teachers, instructors, counselors, principals and aides can deduct up to $250 of out-of-pocket expenses on line 23 of Form 1040 (up to $500 if MFJ and both spouses are educators). To qualify, the taxpayer must have spent at least 900 hours during a school year as an educator. Qualified expenses include amounts paid for books, supplies (other than nonathletic supplies for courses of instruction in health and PE), computer software and equipment, and other equipment and materials used in the classroom. Amounts that cannot be deducted above the line can be deducted as unreimbursed employee business expenses, subject to the 2%-of-AGI limit.

~~**Caution:** The special rule allowing teachers to deduct out-of-pocket expenses expired at the end of 2009 but, at the time of this publication, Congress was considering an extension to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Per Diem Rates

See also IRS Pub. 1542

Per Diem Substantiation Methods

The per diem rates set by the IRS for meals, lodging and other incidental expenses vary depending on the travel location. The per diem rates for travel are revised each year on October 1. For the last three months of the year, taxpayers use either the per diem rates effective October 1 of the preceding year or the revised rates effective October 1 of the current year. They must use either the current rates or the revised rates consistently for all travel during that period.

Meals and incidental expenses (M&IE) rate. Instead of deducting actual expenses incurred for M&IE while traveling for business, employees and self-employed individuals may deduct IRS-approved per diem amounts, provided they can document the time, place and business purpose for the travel. Also, employees and self-employed individuals who are reimbursed for their meals and incidental expenses are treated as substantiating the amount of those

MACRS Recovery Periods (2010)

See IRS Pub. 946 *for more recovery periods. Note the recovery periods assigned to certain assets used in specific activities.*	Recovery Period (Years)	
	GDS/ AMT After 1998	ADS/ AMT Before 1999
Agriculture		
Agricultural machinery and equipment	7[1]	10
Breeding or dairy cattle	5	7
Breeding or work horses (12 years old or less)	7	10
Breeding or work horses (more than 12 years old)	3	10
Race horses	3	12
Breeding hogs	3	3
Breeding sheep and goats	5	5
Farm buildings, other than single purpose	20	25
Fences (agricultural)	7	10
Grain bins	7	10
Single-purpose agricultural or horticultural structures	10	15
Trees and vines bearing fruit—must use SL	10	20
Drainage facilities	15	20
Distributive Trades and Services		
Assets used in wholesale and retail trade and personal and professional services	5	9[2]
Manufacturing		
Assets used to manufacture these finished products:		
Apparel, packaging, textiles	5	9
Wood and furniture	7	10
Plastic—special tools	3	3.5
Glass—special tools	3	2.5
Food and beverage—special handling devices	3	4
Minerals		
Assets used in drilling for oil and gas wells (onshore)	5	6
Assets used in exploration and production of oil and gas	7	14
Office Related		
Office furniture, fixtures and equipment	7	10
Cell phones and fax machines	7	10
Computers and peripheral equipment	5	5
Typewriters, calculators, copiers	5	6
Computer software	See *Computer Software* on Page 10-13.	
Real Property		
Land improvements (sidewalks, roads, fences, etc.)	15	20
Qualified leasehold improvements	15 ~~39[3]~~	39 ~~40[3]~~
Qualified restaurant property	15 ~~39[3]~~	39 ~~40[3]~~
Qualified retail improvement property	15 ~~39[3]~~	39 ~~40[3]~~
Residential rental real property—including mobile homes	27.5	40
Nonresidential real property	39	40
Transportation		
Airplanes (noncommercial) and helicopters	5	6
Automobiles, taxis	5	5
Buses	5	9
Light general purpose trucks (less than 13,000 lbs.)	5	5
Heavy general purpose trucks (13,000 lbs. or more)	5	6
Tractor units (for over-the-road use)	3	4
Trailers (for over-the-road use)	5	6
Water transportation equipment	10	18
Other		
Appliances, carpets and furniture used in residential rental property	5	9
Personal property with no class life	7	12

[1] For 2009, the recovery period for new farm machinery and equipment was five years. ~~At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

[2] Five years for high technology medical equipment.

~~[3] For 2009, the recovery period was 15 years (39 years for ADS). At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Conventions

Half-year convention. Treats all property placed in service or disposed of during a tax year as placed in service, or disposed of, on the midpoint of that tax year. The half-year convention applies to all property except:

1) Residential rental and nonresidential real property and
2) Property subject to the mid-quarter convention.

Mid-quarter convention. If the basis of property placed in service in the last three months of the year is more than 40% of the total depreciable basis of property placed in service during the entire year, the mid-quarter convention applies. Then, all property placed in service during that tax year is treated as placed in service, or disposed of, at the midpoint of the quarter it is placed in service or disposed of.

Excluded items. To determine if the mid-quarter convention applies, the following items are not counted:

1) Property depreciated under a method other than MACRS,
2) Residential rental property,
3) Nonresidential real property,
4) Property placed in service and disposed of in the same tax year and
5) Property expensed under Section 179.

Mid-month convention. Treats all property placed in service or disposed of during any month as placed in service or disposed of on the midpoint of that month. This convention applies to residential rental and nonresidential real property.

Land Improvements

Land is not depreciable. The cost of grading, excavating, soil removal, ditching, landscaping, etc., is generally considered part of the cost of the land and, therefore, not depreciable. However, if these activities bear a "direct association" with the construction of the building, the costs are part of construction costs and are depreciable. For example, landscaping so close to a building that it would be destroyed if the building were replaced can be depreciated.

Idle Assets

If an asset is usually used for business purposes but is temporarily idle, it is still depreciated.

Abandonment of Depreciable Property

The depreciation period ends when an asset is retired from service. Depreciation is allowed in the final year based on the convention that applies to the property. If there is any remaining basis in the asset, a loss may be deducted if the asset is scrapped or abandoned. In order to deduct a loss from physical abandonment, the taxpayer must intend to irrevocably discard the asset so that it will neither be used nor retrieved by the taxpayer for sale, exchange or other disposition [Reg. §1.167(a)-8]. Long-term losses on assets used in a business are reported in Part I of Form 4797; short-term losses are reported in Part II.

Special Depreciation Allowance

IRC §168(k) (or 100%)

A special (bonus) depreciation allowance equal to 50% of the depreciable basis of qualified property is claimed in Part II of Form 4562 for assets purchased and placed in service during 2010.

Strategy: If the special depreciation allowance is taken, there are no AMT adjustments for depreciation for that asset for the year placed in service or any later year. (or 100%)

The special depreciation allowance equals 50% of the asset's depreciable basis (cost or other basis *less* Section 179 deduction and credits, such as the hybrid vehicle and disabled access credits).

The amount of the special depreciation allowance is not affected by a short taxable year, or by the applicable convention. (See *Conventions* on Page 10-2.) But, assets for which the special depreciation allowance is claimed are still counted for determining whether the mid-quarter convention applies for the "normal" MACRS deduction.

Note: For 2010, the 100% allowance applies to property acquired and placed in service 9/9/10–12/31/10.

Qualified Property

To qualify for the special depreciation allowance, the property must be a new asset (see *Original use* below) that is either:

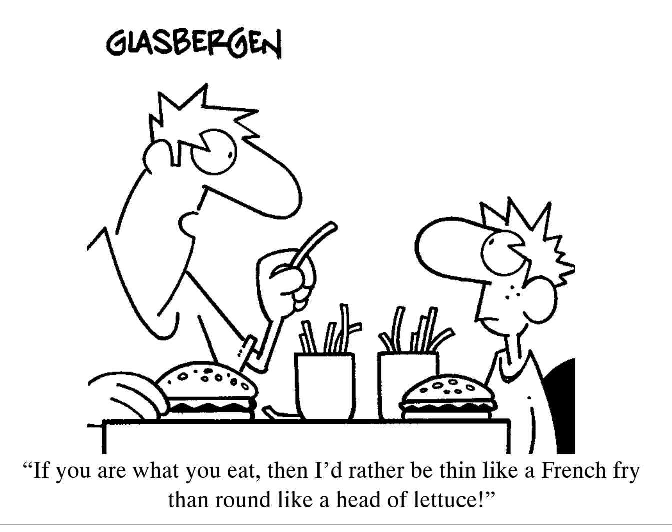
- MACRS property with an applicable recovery period of 20 years or less,
- Computer software (other than computer software covered by Section 197),
- Water utility property or
- Qualified leasehold improvement property. See *Qualified Leasehold Improvements* Page 10-13.

Business vehicles. The Section 280F limit on depreciation that applies to many vehicles is increased in 2010 by $8,000 for vehicles for which special depreciation is claimed. See the *Business Vehicles—Quick Facts* table on Page 11-1.

Original use. To qualify for special depreciation, the asset must generally be new, rather than used. However, new property that a taxpayer acquired for personal and later converted to business use meets the original-use requirement. [Reg. §1.168(k)-1(b)(3)]

Electing Out

Taxpayers can elect not to claim special depreciation for any class of property by attaching a statement to the tax return. The election out applies to all additions to an asset class (for example, five-year property) for the year. [IRC §168(k)(2)(D)]



"If you are what you eat, then I'd rather be thin like a French fry than round like a head of lettuce!"

Election Out of Special Depreciation Allowance

Taxpayer elects under IRC Sec. 168(k)(2)(D)(iii) not to claim the 50% special depreciation allowance for the following classes of property placed in service during the tax year ended [insert year-end]: [List property classes for which election is made.]

Alternative Minimum Tax Adjustments

To compute alternative minimum tax (AMT), certain adjustments are made to MACRS depreciation deductions.

AMT Depreciation Methods and Adjustments

Placed in Service after 1998[1]

MACRS Property	MACRS Method/Recovery Period[2]	AMT Method/ Recovery Period[2]	AMT Adjustment
3-, 5-, 7- and 10-yr property	200% DB GDS	150% DB GDS	Difference between 200% and 150% DB methods.
15 and 20-yr property and farm property	150% DB GDS	150% DB GDS	None.
Property for which MACRS SL elected	SL GDS	SL GDS	None.
Property for which AMT 150% DB elected	150% DB GDS	150% DB GDS	None.
15-year §1250 property	150% DB 15 yrs	SL 15 yrs	Difference between 150% DB and SL.
27.5-yr residential real property	SL 27.5 yrs	SL 27.5 yrs	None.
39-yr nonresidential real property	SL 39 yrs	SL 39 yrs	None.

[1] For property placed in service after 1986 and before 1999, the ADS recovery period generally applied for AMT purposes so, the AMT adjustment is sometimes the result of differences in both the depreciation method and recovery period.

[2] See *MACRS Recovery Periods (2010)* on Page 10-2 for GDS and ADS recovery periods.

No AMT adjustment is required for the following:

- Residential rental property placed in service after 1998.
- Nonresidential real property with a class life of 27.5 years or more placed in service after 1998.
- Other Section 1250 property placed in service after 1998 that is depreciated for regular tax using the SL method.
- Property (other than Section 1250 property) placed in service after 1998 that is depreciated for regular tax purposes using the 150% DB method or the SL method.
- Property depreciated using ADS for regular tax purposes.
- Property for which the special depreciation allowance under Sections 168(k) is claimed. See *Special Depreciation Allowance* in the previous column.
- Qualified disaster assistance property for which a special depreciation allowance under IRC §168(n) is claimed. See *Federally Declared Disasters* on Page 5-15.
- Property for which a special depreciation allowance was claimed because it replaced property damaged in the New York terrorist acts on September 11, 2001, by Hurricane Katrina or by the Kansas storms that occurred in 2007. See Pubs. 4492 and 4492-A for details.
- Property to the extent a Section 179 election is made.

Depreciation method:

a) If the replacement property and the relinquished property have the same depreciation method, use the depreciation method of the relinquished property.

b) If the replacement property has a more accelerated depreciation method than the relinquished property, use the depreciation method of the relinquished property.

c) If the replacement property has a slower depreciation method than the relinquished property, use the depreciation method of the replacement property as if it had originally been placed in service in the same taxable year as the relinquished property.

2) *Excess basis* is any excess of the basis in the replacement property over the exchanged basis (this is normally boot paid). Determine the recovery period and depreciation method for the excess basis of the replacement property using the applicable recovery period and depreciation method for the property at the time of the exchange. Section 179 deduction can be claimed.

Electing out. Taxpayers may elect out of these depreciation rules for like-kind exchanges. In this case, the exchanged basis and excess basis, if any, in the replacement property are treated as being placed in service at the time of replacement and the adjusted depreciable basis of the relinquished property is treated as being disposed of by the taxpayer at the time of disposition. The election must be made by the due date (including extensions) of the tax return for the year of replacement, and is made by reporting the depreciation for the replacement property (computed as described above) in Part III of the Form 4562. Also, attach a statement indicating "Election made under Section 1.168(i)-6(i)" for each property involved in the exchange. The election may be revoked only with the consent of the IRS.

Computer Software

Cost of acquired computer software:

- Software included in the purchase price of a computer (not separately stated) is added to the basis of the computer and depreciated over five years, or expensed under Section 179.
- Software readily available for purchase by the general public is depreciable as intangible property over 36 months using the SL method beginning with the month the software is placed in service [IRC §167(f)(1)]. Include depreciation on line 16 of Form 4562, as "other depreciation." For tax years beginning after 2002 and before 2012, off-the-shelf computer software is eligible for the Section 179 deduction.
- Purchased software with a useful life of less than one year is deductible as a current expense.

Cost of developing computer software:

- Treat as a current expense and deduct in accordance with the rules for research and experimental expenditures or
- Treat as a capital expenditure. Amortize ratably over a period of 60 months from the date of completion of the development or 36 months from the date the software is placed in service. (Rev. Proc. 2000-50)

Leased or licensed software. Deduct as a rental expense.

Software included in purchase price of a trade or business. Amortize over 15 years beginning with the month acquired. (IRC §197)

Leasehold Improvements

General Rules

Generally, any improvement to depreciable property has the same recovery period and method as the improved property (but is treated as placed in service when the improvement is made). So an improvement to a commercial building [whether made by the lessor (landlord) or the lessee (tenant)] generally would be depreciated straight-line over 39 years. But, see *Qualified Leasehold Improvements* below for special rules.

Lessee (tenant). Any remaining undepreciated basis is deductible by the lessee when the lease terminates.

Lessor (landlord). The lessor can deduct the undepreciated basis of the improvement at the end of the lease term only if the actual improvement is irrevocably disposed of or abandoned by the lessor at the termination of the lease. [IRC §168(i)(8)]

Special Rules for Certain Buildings and Improvements

Leasehold Improvements, Retail and Restaurant Property—Special Rules (2010)

	Qualified Leasehold Improvement Property	Qualified Restaurant Property	Qualified Retail Improvement Property
MACRS recovery period	15 ~~39 yr[1]~~	15 ~~39 yr[1]~~	15 ~~39 yr[1]~~
Eligible for ~~50%~~ special (bonus) depreciation	Yes	No	No
Eligible for Section 179 deduction	Yes[2]	Yes[2]	Yes[2]
Includes:			
• Building interiors	Yes	Yes	Yes
• Buildings	No	Yes	No
• Elevators and certain structural improvements?[3]	No	Yes	No
Must be placed in service more than three years after building placed in service?	Yes	No	Yes
Must be made pursuant to a lease?	Yes	No	No

~~[1] For 2009, a 15-year recovery period applied. At publication time, Congress was considering legislation extending the 15-year recovery period to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

[2] Heating and air conditioning units as well as property used to furnish lodging are not eligible.

[3] This includes elevators, escalators, enlargement of the building, structural component benefitting a common area or internal structural framework.

Qualified Leasehold Improvements

Qualified leasehold improvement property is generally any improvement to a building that meets all of the following requirements:

1) The building is nonresidential real property.
2) The improvement is to an interior portion of a building.
3) The improvement was made pursuant to a lease by the tenant, sub-tenant or the landlord to property to be occupied exclusively by the tenant (or sub-tenant).
4) The improvement is placed in service more than three years after the date the building was first placed in service (by any taxpayer).

Autos and Listed Property

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Business Vehicles—Quick Facts

For business vehicles placed in service	2010	2009	2008	2007	2006
Passenger Autos—Unloaded GVW 6,000 lbs or Less [1]					
Section 280F depreciation limits apply when basis exceeds[2]					
If ~~50%~~ special depreciation claimed —50% / 100%	$ 18,433 / 11,060	$ 18,266	$ 18,266	N/A	N/A
If no special depreciation claimed	15,300	14,800	14,800	$ 15,300	$ 14,800
Leased auto income inclusion applies when FMV exceeds:	16,700	18,500	18,500	15,500	15,200
Depreciation limits (annual Section 280F limits)[3, 4]					
Acquisition year if ~~50%~~ special depreciation claimed	$ 11,060	$ 10,960	$ 10,960	N/A	N/A
Acquisition year if no special depreciation claimed	3,060	2,960	2,960	$ 3,060	$ 2,960
Second-year limit	4,900	4,800	4,800	4,900	4,800
Third-year limit	2,950	2,850	2,850	2,850	2,850
All years thereafter	1,775	1,775	1,775	1,775	1,775
Trucks and Vans—Vehicle Built on a Truck Chassis With Loaded GVW 6,000 lbs or Less[1]					
Section 280F depreciation limits apply when basis exceeds[2]					
If ~~50%~~ special depreciation claimed —50% / 100%	$ 18,600 / 11,160	$ 18,433	$ 18,600	N/A	N/A
If no special depreciation claimed	15,800	15,300	15,800	$ 16,300	$ 16,300
Leased auto income inclusion applies when FMV exceeds:	17,000	18,500	19,000	16,400	16,700
Depreciation limits (annual Section 280F limits)[3, 4]					
Acquisition year if ~~50%~~ special depreciation claimed	$ 11,160	$ 11,060	$ 11,160	N/A	N/A
Acquisition year if no special depreciation claimed	3,160	3,060	3,160	$ 3,260	$ 3,260
Second-year limit	5,100	4,900	5,100	5,200	5,200
Third-year limit	3,050	2,950	3,050	3,050	3,150
All years thereafter	1,875	1,775	1,875	1,875	1,875
Heavy Vehicles—Loaded GVW over 6,000 lbs but not more than 14,000 lbs					
Section 179 expensing limit	$ 25,000	$ 25,000	$ 25,000	$ 25,000	$ 25,000
Depreciation limit (annual Section 280F limit)	N/A	N/A	N/A	N/A	N/A
Vehicles Not Subject to Depreciation Limitation Rules					
Autos rated at more than 6,000 lbs. unloaded gross vehicle weight (GVW), trucks and vans rated at more than 6,000 lbs. loaded GVW, and qualified nonpersonal-use vehicles are not subject to the Section 280F depreciation limits.					
Standard Mileage Rates					
Business miles	50¢	55¢	50.5¢: 1/1 – 6/30; 58.5¢: 7/1 – 12/31	48.5¢	44.5¢
Depreciation component of business standard mileage rate	23¢	21¢	21¢	19¢	17¢
Charitable miles	14¢	14¢	14¢	14¢	14¢
Medical or moving miles	16.5¢	24¢	19¢: 1/1 – 6/30; 27¢: 7/1 – 12/31	20¢	18¢

[1] If less than 100% business use, the limits must be reduced to reflect actual business-use percentage.
[2] Assumes half-year convention applies.
[3] This limit applies to the sum of the MACRS depreciation and any Section 179 expense claimed.
[4] For limits in effect before 2006, see the *Section 280F Depreciation Limits for Cars* and *Section 280F Depreciation Limits for Trucks and Vans* tables on Page 11-14.

See the *Business Vehicles—Quick Facts* table on Page 11-1 for the limits that apply to vehicles placed in service during 2006–2010.

Special use vehicles. These vehicles are not subject to the Section 280F depreciation limits. This category includes the following:

1) An ambulance, hearse or combination ambulance-hearse used in a trade or business.
2) A vehicle used in the trade or business of transporting persons or property for compensation or hire (for example, a taxicab).
3) Qualified non-personal use vehicles. See *Qualified non-personal-use vehicles* on Page 11-10.

2010 Deduction Limits for Vehicles

Description	§280F Depreciation Limit [1]	Maximum §179 Deduction
Car—GVW (unloaded) up to 6,000 lbs. • ~~50%~~ special depreciation claimed. • No special depreciation claimed.	 $11,060 3,060	 $11,060 3,060
Truck or van (including SUVs and minivans on a truck chassis)—GVW (loaded) up to 6,000 lbs. • ~~50%~~ special depreciation claimed. • No special depreciation claimed.	 $11,160 3,160	 $11,160 3,160
Car, truck or van (including SUVs and minivans), GVW over 6,000 but not over 14,000 lbs.	N/A	$25,000[2]
Vehicles—GVW over 6,000 but not over 14,000 lbs that: • Are designed to seat more than nine passengers behind the driver seat (for example, a hotel shuttle van); • Have an open cargo area or covered box that is at least six feet long and not readily accessible from the passenger compartment (for example, a pick-up with full-size cargo bed) or • Have an enclosure fully enclosing the driver compartment and load carrying device, do not have seating behind the driver's seat and have no body section protruding more than 30 inches ahead of the windshield (for example a delivery van).	N/A	$500,000[3]
Truck or van, GVW (loaded) over 14,000 lbs.	N/A	$500,000[3]

[1] First year limit; reduce by any §179 expense claimed.
[2] Per vehicle limit. Also subject to overall Section 179 limit ($500,000 for 2010).
[3] Annual limit for all assets expensed.

Section 179 Limit for SUVs

Trucks, vans and SUVs with a loaded GVW greater than 6,000 pounds are not subject to the depreciation limit. However, these vehicles are still considered listed property and are not eligible for accelerated depreciation or a Section 179 expense when business use is 50% or less. See *Listed Property* on Page 11-10.

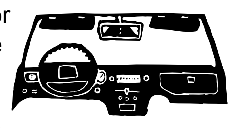
The GVW can normally be found on a label attached to the inside edge of the driver's side door. Some manufacturers also list GVWs for their various models on their websites. Many of the larger trucks and SUVs have a loaded GVW over 6,000 pounds.

Website: GVWs for many vehicles can be found at *www.intellichoice.com* and *www.carsdirect.com/research*.

The Section 179 deduction for heavy passenger vehicles (cars, trucks, vans and SUVs with loaded GVW over 6,000 pounds) with a gross vehicle weight of 14,000 pounds or less is limited to $25,000 per vehicle. For exceptions to the $25,000 Section 179 limit, see the *2010 Deduction Limits for Vehicles* table above.

Calculating Vehicle Depreciation

Step 1: Determine the business/investment use percentage by dividing business/investment miles driven during the year by total miles driven.



Step 2: Multiply the Section 280F limit for the year by the business/investment use percentage. This is the maximum amount that can be claimed as depreciation (including any Section 179 deduction) for the year.

Step 3: Determine the Section 179 deduction. The Section 179 deduction can only be claimed in the year the auto is placed in service and only if business use is more than 50%.

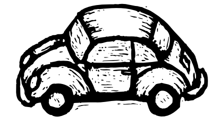
Step 4: Determine the special depreciation allowance. New vehicles acquired and placed in service during 2010 and used more than 50% for business qualify for a ~~50%~~ special depreciation allowance.

Observation: The special depreciation allowance applies unless the taxpayer elects out. See Tab 10 for details.

Step 5: Determine MACRS depreciation. If qualified business use is 50% or less, depreciation must be calculated SL with a five-year recovery period.

See the *Vehicles Subject to Section 280F Limit Depreciation Worksheet* on Page 11-14.

Example: A passenger auto is purchased new on July 10, 2010, for $24,000 and is used 75% for business during 2010. No Section 179 deduction is claimed. The taxpayer does not elect out of the 50% special depreciation allowance.



- $24,000 cost × 75% business use = $18,000
- Section 280F limit = $11,060 × 75% business use = $8,295
- $18,000 × 50% special depreciation allowance = $9,000
- 2010 depreciation is limited to $8,295 (lesser of $9,000 or $8,295)

Electing Straight-Line Depreciation

Even if business use exceeds 50%, a taxpayer may elect to depreciate an auto under the five-year SL method instead of using MACRS. By electing SL depreciation, a taxpayer can avoid the recapture of excess MACRS deductions if business use drops to 50% or less in a later year. The election is made by entering "SL" in column (g) of Part V, Form 4562. The election applies to the entire class of property for the year in which the election is made.

Business Use 50% or Less

Passenger automobiles (see *Passenger auto* on Page 11-2) used 50% or less for business purposes are not eligible for Section 179 expense or special depreciation allowance and must be depreciated over five years using the SL method. The half-year or mid-quarter conventions still apply. See the *Vehicle Depreciation—MACRS Percentages* table on Page 11-4.

Investment use. Investment use is not counted for determining whether a vehicle meets the more than 50% business-use test (to qualify for accelerated depreciation and Section 179 expensing). But, the combined business/investment percentage is used to compute the depreciable portion of the vehicle's basis.

Example #1: An auto is used 40% in a trade or business and 25% for investment. *Method:* SL depreciation must be used based on 65% business/investment use.

Example #2: An auto is used 80% in a trade or business and 10% for investment. *Method:* Accelerated depreciation (200% DB) may be used and calculated based on 90% business/investment use.

earlier accelerated MACRS and Section 179 deductions must be recaptured and reported as ordinary income on Form 4797. Converting a business auto to personal use reduces the business-use percentage to zero, so recapture income will be recognized at the conversion date if the auto was listed property and used more than 50% for business. See *Depreciation Recapture* on Page 11-5.

Auto Improvements

Treat a capital improvement to an automobile as a new asset placed in service in the year of the improvement. Combine the depreciation deductions for both the automobile improvement and for the improved automobile.

Total combined depreciation may not exceed the Section 280F depreciation limit for that year, based on the date the automobile was originally placed in service [Reg. §1.280F-2T(f)]. **Note:** A credit may be available when an auto is converted to a plug-in vehicle. See *Alternative Motor Vehicle Tax Credit* on Page 11-7.

Donating a Car to Charity

If the claimed value of a donated vehicle exceeds $500, the deduction may be limited to the gross sales proceeds the charitable organization receives upon disposition of the vehicle. See *Cars, Boats and Airplanes* on Page 5-13 for more information.

Blue Book value. One common method to assist in determining the FMV of an auto is with *Kelley Blue Book* values. Blue book values are not official, but provide a standard for comparison purposes. Blue book values are available at *www.kbb.com*.

Auto Trade-In Rules

Reg. §1.168(i)-6(d)(3)

When an auto is traded in for a new vehicle, the like-kind exchange rules apply. The taxpayer's basis for depreciating in the new vehicle consists of two separate components:

1) The exchanged basis and
2) The excess basis, if any.

See *Like-Kind Exchanges—Depreciation Rules* on Page 10-12 for a discussion of the exchanged basis and the excess basis in a like-kind exchange.

Depreciating Vehicles Acquired in a Trade
[Reg. §1.168(i)-6(d)(3)]

Step	Compute:	Deduction limited to:
1	Depreciation on old car. Use applicable convention for the year of disposition.	*Lesser of:* 280F limit for the old car or the limit for the new car.[1]
2	~~50%~~ special depreciation[2] on new car's exchanged basis (basis in the old car after step 1).	280F limit for the new car, less amount deducted in step 1.
3	MACRS depreciation on new car's exchanged basis (after ~~50%~~ special depreciation). Use same convention as for old car and the remaining recovery period.	*Lesser of:* 280F limit for the old car or the limit for the new car, less amounts deducted in steps 1 and 2.
4	Section 179 expense on the new car's excess basis.	280F limit for new car, less amounts deducted in steps 1–3.
5	~~50%~~ special depreciation[2] on new car's excess basis (after Section 179).	280F limit for new car, less amounts deducted in steps 1–4.
6	MACRS depreciation on new car's excess basis (after Section 179 and special depreciation). Use applicable convention for the acquisition year and five-year recovery period.	280F limit for new car, less amounts deducted in steps 1–5.

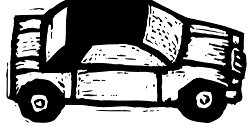
[1] If the replacement vehicle is acquired in a year after the year of disposition, depreciation in limited to the 280F limit for the old car.

[2] If vehicle is eligible and taxpayer does not elect out.

Note: Cars, light general purpose trucks (for use over the road and weigh less than 13,000 pounds), crossovers, SUVs, minivans and cargo vans are like-kind property. (Ltr. Rul. 200912004)

The Section 280F depreciation limit applies for computing the year-of-disposition depreciation for the old vehicle and for depreciating the new vehicle. In the exchange year, total depreciation claimed on both vehicles cannot exceed the Section 280F limit for the new vehicle.

Practice Tip: Taxpayers can elect not to apply like-kind exchange treatment by attaching a statement to a timely filed return (including extensions) stating "Election made under Reg. 1.168(i)–6(i)" for each property involved in the exchange. If this election is made, the entire basis of the replacement property is depreciated as a new asset on Form 4562. See the *Basis Worksheet—Vehicle Acquired in a Trade-In* on Page 11-14 for how to compute basis when the election out is made.



Caution: An employee who trades in an auto used for business as an employee elects out of the depreciation rules for like-kind exchanges by completing Form 2106, Part II, Section D to report the auto's depreciation. If the employee does not elect out of the general rules, depreciation for the auto acquired in the exchange is reported on Form 4562.

Example: Jim purchased a Honda in February 2007 for $20,000. He used it 100% in his business. In ~~November~~ August 2010, Jim exchanges, in a like-kind exchange, his Honda plus $14,000 cash for a new Mazda that will also be used solely in his business. The Mazda qualifies for 50% special depreciation. Jim also claims a $2,000 Section 179 deduction on the Mazda's excess basis. The 2010 Section 280F limit for the Honda (if the trade hadn't occurred) is $1,775. The 2010 280F limit for the Mazda is $11,060. The depreciation and basis calculations for 2010 are as follows:

	Depreciation/ Section 179	Basis
Honda basis at December 31, 2009 ($20,000 cost – $3,060 – $4,900 – $2,850)		$ 9,190
Step 1: 2010 depreciation on Honda ($20,000 × 11.52%, limited to $1,775)	$ 1,775	< 1,775>
Exchanged basis in Mazda		7,415
Step 2: 50% special depreciation on Mazda exchanged basis ($7,415 × 50%, limited to $11,060 – $1,775 = $9,285)	3,708	< 3,708>
Step 3: Regular deprecation on Mazda exchanged basis (limited to $1,775 – $1,775 – $3,708= $0)	0	< 0>
Mazda exchanged basis at December 31, 2010		$ 3,707
Mazda excess basis		$14,000
Step 4: Sec. 179 deduction (limited to $11,060 – $1,775 – $3,708 = $5,577)	2,000	< 2,000>
Step 5: 50% special depreciation on excess basis [50% × ($14,000 – $2,000), limited to $11,060 – $1,775 – $3,708 – $2,000 = $3,577]	3,577	< 3,577>
Step 6: Regular depreciation on Mazda excess basis [($14,000 – $2,000 – $3,577) × 20%, limited to $11,060 – $1,775 – $3,708 – $2,000 – $3,577 = $0]	0	< 0>
Mazda excess basis at December 31, 2010		$ 8,423
Total 2010 depreciation	$ 11,060	
Basis of Mazda at end of 2010 ($3,707 + $8,423)		$12,130

Basis Worksheet—Vehicle Acquired in a Trade-In

Note: This method is used if the taxpayer elects to treat the trade-in as a tax-free disposition [that is, elects out of the general rules of Reg. § 1.168(i)-6(i)]. See *Auto Trade-In Rules* on Page 11-6 for details.

1) Original basis of old vehicle, reduced by any tax credits .... 1) $__________

2) Total depreciation allowed on the old vehicle (including amount for year of trade)............ 2) __________

3) Adjusted basis of old vehicle before trade-in adjustment—Line 1 minus line 2 .... 3) __________

4) Cash and FMV of other property paid to the to the other party .... 4) __________

5) Liabilities assumed or taken out by taxpayer............ 5) __________

6) Liabilities assumed by the other party .... 6) <__________>

7) Additional basis in the new vehicle—Sum of lines 4 through 6............ 7) __________

8) **Basis in the new vehicle**. Line 3 plus line 7. This is the original basis in the vehicle for sale or exchange purposes .... 8) __________

9) Depreciation that would have been allowed (through year of trade) on the old vehicle at 100% business use .... 9) __________

10) Actual depreciation allowed (line 2) .... 10) __________

11) Excess depreciation—Line 9 minus line 10............ 11) __________

12) Trade-in adjustment: *Lesser* of excess amount (line 11) or adjusted basis of old vehicle (line 3)...... 12) __________

13) **Basis for depreciation**. Line 8 minus line 12......... 13) __________

Section 280F Depreciation Limits for Cars—Placed in Service before 2006

Date Placed In Service	1st Year	2nd Year	3rd Year	4th & Later
2005	$ 2,960	$ 4,700	$ 2,850	$ 1,675
2004	10,610[1]	4,800	2,850	1,675
5/06 – 12/31/2003	10,710[2]	4,900	2,950	1,775
1/01 – 5/05/2003	7,660[2]	4,900	2,950	1,775
2001 – 2002	7,660[3]	4,900	2,950	1,775
2000	3,060	4,900	2,950	1,775
1999	3,060	5,000	2,950	1,775
1998	3,160	5,000	2,950	1,775

See the *Business Vehicles—Quick Facts* table on Page 11-1 for limits for vehicles placed in service after 2005.

[1] $2,960 if special depreciation allowance not claimed.

[2] $3,060 if special depreciation allowance not claimed.

[3] $3,060 if acquired before 9/11/2001 or special depreciation not claimed.

Section 280F Depreciation Limits for Trucks and Vans—Placed in Service in 2003–2005

Date Placed In Service	1st Year	2nd Year	3rd Year	4th & Later
2005	$ 3,260	$ 5,200	$ 3,150	$ 1,875
2004	10,910[1]	5,300	3,150	1,875
5/06 – 12/31/2003	11,010[2]	5,400	3,250	1,975
1/01 – 5/05/2003	7,960[2]	5,400	3,250	1,975

See the *Business Vehicles—Quick Facts* table on Page 11-1 for limits for vehicles placed in service after 2005. For trucks and vans placed in service before 2003, use the *Section 280F Limits for Cars* table above.

[1] $3,260 if special depreciation not claimed.

[2] $3,360 if special depreciation not claimed.

Vehicles Subject to Section 280F Limit Depreciation Worksheet

Part I

1) MACRS system (GDS or ADS)............ 1) __________

2) Property class............ 2) __________

3) Date placed in service .... 3) __________

4) Recovery period .... 4) __________

5) Method and convention .... 5) __________

6) Depreciation rate (see the *Vehicle Depreciation—MACRS Percentages* table on Page 11-4 for 200% and SL methods and the *5-Year MACRS* table on Page 10-4 for 150% DB method) .... 6) __________

7) Section 280F limit for this year (based on year placed in service). See the *Business Vehicles—Quick Facts* table on Page 11-1 .... 7) __________

8) Business/investment-use percentage............ 8) __________%

9) Multiply line 7 by line 8. This is the adjusted Section 280F limit............ 9) __________

10) **Section 179 deduction** (not more than line 9). Enter -0- if this is not the year the vehicle is placed in service .... 10) __________

Note:

- If line 10 is equal to line 9, stop here. The combined Section 179 and depreciation deduction is limited to the amount on line 9.
- If line 10 is less than line 9, complete Part II.

Part II

11) Subtract line 10 from line 9. This is the limit on the deduction for depreciation (including any special depreciation allowance)............ 11) __________

12) Cost or other basis (reduced by credits, such as the alternative motor vehicle credit claimed on the vehicle) .... 12) __________

13) Multiply line 12 by line 8. This is the business/investment cost............ 13) __________

14) Section 179 claimed in the year the vehicle was placed car in service............ 14) __________

15) Line 13 minus line 14. This is the tentative basis for depreciation............ 15) __________

16) **Special depreciation allowance**. If vehicle was placed in service in 2010 and eligible for special depreciation, multiply line 15 by 50% (or 100%). Otherwise, enter zero .... 16) __________

Note:

- If line 16 is equal to or greater than line 11, stop here. The special depreciation deduction is limited to the amount on line 11.
- If line 16 is less than line 11, complete Part III.

Part III

17) Line 11 minus line 16. This is the limit on the MACRS depreciation deduction .... 17) __________

18) Subtract line 16 from line 15. This is the basis for depreciation............ 18) __________

19) Multiply line 18 by line 6. This is the tentative MACRS depreciation deduction .... 19) __________

20) **MACRS depreciation**. Enter the lesser of line 17 or line 19 .... 20) __________

— End of Tab 11 —

Tax Credits, AMT and Special Taxpayers

Tab 12 Topics

Tax Credits Summary (2010) .... Page 12-1
Adoption Credit or Benefit Exclusion .... Page 12-2
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Earned Income Credit .... Page 12-6
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Tax Credits Summary (2010)

For information on additional credits available to individuals, see *Line-By-Line Quick Reference to 2010 Form 1040* on Page 4-1.

Tax Credit	IRC §	For	Rate	IRS Pub	Tax Form	Refundability, Carryover	Allowed Against AMT?	QF Page
Additional Child	24	Taxpayers who don't claim full $1,000 tax credit for each child and have (1) one or more qualifying children and over $3,000 of earned income or (2) three or more qualifying children.	Up to $1,000 per child.	972	8812	Partially refundable	Yes	12-6
Adoption Expense	23	Expenses incurred in the legal adoption of a child under age 18 or for the adoption of an incapacitated or special needs person (regardless of age). Credit is phased out for modified AGI between $182,520–$222,520.	$13,170 for a special needs child; up to $13,170 per child for all other adoptions.	17	8839	Refundable	Yes	12-2
Alternative Motor Vehicle	30B	New hybrid and advanced lean-burn technology vehicles placed in service during the year.	Various limits based on models.	17	8910	Nonrefundable	Yes	11-7
Child and Dependent Care	21	Care expenses for dependent(s) under age 13 or incapacitated that allow taxpayer to work or look for work.	20% to 35% of qualifying (limited) expenses depending on AGI level.	503	2441	Nonrefundable	~~No~~‡ Yes	12-3
Child	24	Taxpayers with qualifying children under age 17. Phase-out begins at modified AGI over $110,000 MFJ; $75,000 Single, HOH and QW; $55,000 MFS.	$1,000 per child.	972	1040	Generally nonrefundable	Yes	12-5
Earned Income	32	Working taxpayers with the following number of children: • None; AGI < $13,460 ($18,470 if MFJ). • One; AGI < $35,535 ($40,545 if MFJ). • Two; AGI < $40,363 ($45,373 if MFJ). • Three or more; AGI < $43,352 ($48,362 if MFJ).	Maximum credit: • $457 for no children. • $3,050 for one child. • $5,036 for two children. • $5,666 for three or more children.	596	Sch. EIC	Refundable	Yes	12-6
Education—American Opportunity	25A	Up to four years of qualified higher education expenses. Credit is per student. Modified AGI phase-out: $80,000–$90,000 ($160,000–$180,000 for MFJ).	Up to $2,500 (100% of first $2,000; 25% of next $2,000).	970	8863	Partially refundable (40%)	Yes	12-9
Education—Lifetime Learning	25A	Postsecondary education and courses to acquire or improve job skills. Credit per return. Modified AGI phase-out: $50,000–$60,000 ($100,000–$120,000 for MFJ).	Up to $2,000 (20% of first $10,000).	970	8863	Nonrefundable	~~No~~‡ Yes	12-9
Elderly or Disabled	22	Low-income taxpayers age 65 or older or permanently and totally disabled. Nontaxable Social Security (or equivalent) must be less than $7,500 MFJ if both spouses qualify.	Based on filing status, age and income. For MFJ also based on spouse's age and income.	524	Sch. R	Nonrefundable	~~No~~‡ Yes	4-20
Federal Tax Paid on Fuels	34	Fuels used on a farm for farming purposes, for off-highway business use and other qualified uses.	Varies by type of fuel and use.	510	4136	Refundable	Yes	—
First-Time Homebuyer	36	First-time homebuyers and certain existing homeowners who purchase a home. Credit phases out for higher income taxpayers.	Lesser of (1) $8,000 ($4,000 MFS) or (2) 10% of purchase price. Limit is $6,500 ($3,250 MFS) for existing homeowners.	17	5405	Refundable	Yes	12-10
Foreign Tax	27 and 901(a)	Income taxes paid to a foreign country or U.S. possession on income that is also subject to U.S. federal income tax.	Amount of foreign tax up to U.S. tax multiplied by ratio of foreign/total taxable income.	514	1116	Nonrefundable; back 1 yr; fwd 10 years	Yes	12-11

Table continued on the next page

Tax Credits Summary (2010) (Continued)								
Tax Credit	**IRC §**	**For**	**Rate**	**IRS Pub**	**Tax Form**	**Refundability, Carryover**	**Allowed Against AMT?**	**QF Page**
Health Coverage	35	Individuals eligible to receive trade adjustment allowance or who receive pension benefits from the PBGC.	80% of qualified health insurance cost.	502	8885	Refundable	Yes	12-11
Making Work Pay	36A	Individuals with earned income; must have SSN; reduced by the $250 economic recovery payment made to certain retirees in 2010, if any. Modified AGI phase-out: $75,000–$95,000 ($150,000– $190,000 for MFJ);	Lesser of (1) 6.2% of earned income or (2) $400 ($800 MFJ).	17	Sch. M	Refundable	Yes	12-11
Minimum Tax	53	Credit allowed against regular tax for part of the alternative minimum tax (AMT) paid and attributable to deferral items (timing preferences and adjustments).	AMT attributable to deferral items.	17	8801 6251	Partially refundable; fwd indefinitely	Yes (refundable part)	12-15
Mortgage Interest	25	Part of interest expense paid by homebuyers issued a government mortgage credit certificate.	Based on interest paid and credit rate under certificate.	530	8396	Nonrefundable; fwd 3 years	Yes	—
Personal Energy Property	25C	Homeowners who install certain energy saving improvements such as insulation, doors, windows, heat pumps, etc.	30% of cost; $1,500 (aggregate limit) for both 2009 and 2010.	17	5695	Nonrefundable	~~No[1]~~ Yes	12-12
Residential Energy Efficient Property	25D	Following property installed on taxpayer's personal residences (principal residence only for fuel cell): solar water heating, solar electric, fuel cells, small wind energy, geothermal heat pump.	30% of cost; $1,000/kW limit for fuel cells.	17	5695	Nonrefundable; fwd indefinitely	Yes	12-13
Retirement Saver's	25B	For individuals who make retirement plan contributions. Credit in addition to tax deduction. AGI ≤ $55,500 MFJ; $41,625 HOH; $27,750 Single, MFS, QW.	10% to 50% of contributions. Maximum: $2,000 MFJ, $1,000 other.	590	8880	Nonrefundable	Yes	12-13
Small Employer Health Insurance	45R	Certain employers who pay health insurance premiums for their employees.	Up to 35% of premiums paid (state average premium for small market, it less).	—	8941	Nonrefundable; back 5, fwd 20.[2]	Yes	12-13

~~[1] For 2009, credit could offset both regular tax and AMT. At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

[2] For 2010, a general business credit (which includes the small employer health insurance credit) for a small business (average gross receipts of $50 million or less) can be carried back for five years (instead of the normal one-year period).

Adoption Credit or Benefit Exclusion

Form 8839; See also IRC §23 and §137

Taxpayers adopting an eligible or special needs child may be able to take an adoption expense tax credit (IRC §23) and/or exclude employer-provided adoption benefits from income (IRC §137). Both a credit and exclusion may be claimed for the same adoption; however, both cannot be claimed for the same expense. File Form 8839, *Qualified Adoption Expenses*, to claim the credit or exclusion.

AMT. The credit can offset both regular tax and AMT.

Refundable. For 2010 and 2011, the credit is refundable. It is claimed on line 71 of Form 1040. Check the "8839" box on that line.

Any carryforward of an unused credit to 2010 is treated as a 2010 credit and, therefore, is refundable.

Married couples must file a joint return to take the adoption credit or exclusion. An individual is not considered married if legally separated under a decree of divorce or separate maintenance.

Married and living apart. A married individual can take the credit or the exclusion on a separate return if the individual:

- Lives apart from his spouse for the last six months of the tax year,
- Provides the home that is the eligible child's home for more than half the year and
- Pays more than half the cost of keeping up that home for the year.

Qualifying Child

A credit or exclusion can be claimed with respect to the expenses of adopting either an eligible child or a child with special needs.

Eligible child. A child who is either:

- Under age 18 or
- Physically or mentally incapable of caring for himself/herself.

Special needs child. A child who meets the following two requirements:

1) Child is a citizen or resident of the United States (including U.S. possessions) and
2) A state determines that the child cannot or should not be returned to the parents' home, and unless adoption assistance is provided to the adoptive parents, the child will probably not be adopted due to a specific factor or condition. *Example of factors/conditions:* Child's ethnic background, age, membership in a minority or sibling group, medical condition, or physical, mental or emotional handicap.

Child's Identifying Number (SSN, ITIN, ATIN)

Form 8839 requires an identifying number for each eligible child. Use whichever of the following numbers is appropriate.

1) *Social Security number (SSN)* if the child has one or if the parents can obtain one in time to file a tax return. Apply for an SSN on Form SS-5.
2) *Individual Taxpayer Identification Number (ITIN)* if the child is a resident or nonresident alien and not eligible for a SSN. Apply for an ITIN on Form W-7.
3) *Adoption Taxpayer Identification Number (ATIN)* if the child is a U.S. citizen or resident and the parents are unable to obtain the child's existing SSN or apply for a new SSN until the adoption is final. An ATIN may be obtained by filing Form W-7A with the IRS along with a copy of legal placement papers. The ATIN will remain in effect for two years. An extension is available.

Note: An ATIN may be used to claim the child's dependency exemption, the child care credit or the child tax credit; an ATIN may not be used to claim the EIC.

Dollar and AGI Limitations

Credit and exclusion limits:

- The credit or exclusion is based on the amount of qualifying adoption expenses the taxpayer pays in connection with the adoption (except for the adoption of a special needs child, see below).
- For 2010, the limit is $13,170 for the adoption of each eligible child.
- The limit is a cumulative, per child limit over all tax years (not an annual limit).
- Limit applies separately to the credit and exclusion (each can be up to $13,170 per child in 2010) if both are taken.
- Expenses of an unsuccessful adoption are combined with expenses of a later successful adoption for dollar limits.

Special needs child. The $13,170 credit or exclusion is allowed for the adoption of a special needs child even if the taxpayer does not have qualified adoption expenses.

> **Example:** Mark and Peggy adopt a special needs child and the adoption is finalized in 2010. Their actual adoption expenses are only $6,000. They are still allowed to claim the full $13,170 credit in 2010.

AGI limit. The credit and exclusion are phased out for taxpayers with a modified AGI between $182,520 and $222,520 (for 2010). The AGI phase-out is applied only in the year the adoption credit is generated, and is not applied in future years to reduce any credit carryovers.

Qualified Adoption Expenses	
Includes:	**Does not include:**
• Adoption fees. • Attorneys fees. • Court costs. • Travel expenses (including meals and lodging) while away from home. • Re-adoption expenses related to the adoption of a foreign child.	• Expenses paid under any state, local or federal program. • Expenses that violate state law. • Cost of carrying out a surrogate parenting arrangement. • Cost of adopting spouse's child. • Expenses paid or reimbursed by employer, another person or an organization. • Cost otherwise allowed as a deduction or credit.

When to Claim Adoption Credit or Exclusion		
	Domestic Adoption	**Foreign Adoption**[1]
Adoption Credit		
Expenses paid in a year…	*Claim credit in…*	
Before adoption is final	Following year	Year adoption is final
Adoption is final	Year paid	Year paid
After adoption is final	Year paid	Year paid
Exclusion for Employer-Provided Adoption Benefits		
Benefits received in a year…	*Claim exclusion in…*	
Before adoption is final	Year received	Year adoption is final[2]
Adoption is final	Year received	Year received
After adoption is final	Year received	Year received

[1] For a foreign adoption, credit and/or exclusion is allowed only if adoption becomes final.

[2] See Form 8839 instructions on how to report employer provided benefits in years before the adoption is final.

When Is a Foreign Adoption Final?

A foreign adoption that is a *convention adoption* is considered final in the year that either (1) the foreign country enters a final decree of adoption or (2) the Secretary of State issues a Hague Adoption Certificate. (Rev. Proc. 2010-31)

A convention adoption is the adoption of a non-U.S. citizen or resident child who, in connection with the adoption has moved, or will move, from a country that is a party to the Hague Convention on Protection of Children and Cooperation in Respect of Intercountry Adoption, if the adoptive parent has filed an Application for Determination of Suitability to Adopt a Child from a Convention Country (Form 1-800A or successor) with the Department of State on or after April 1, 2008. A list of countries that are parties to the Hague convention can be found at *www.adoption.state.gov/hague/overview/countries.html*.

See Rev. Proc. 2005-31 for when a foreign adoption that is not a convention adoption is final.

Substantiation Requirements

Starting in 2010, taxpayers must attach a copy of the adoption order or decree to their tax return if they claim the adoption credit for a domestic or foreign adoption finalized in the U.S. Taxpayers claiming the credit for a domestic adoption that is not final must include the child's adoption TIN on their return or attach one of the following to the return:

1) Home study completed by an authorized placement agency.
2) Placement agreement with an authorized placement agency.
3) Document signed by a hospital official authorizing the release of a newborn child from the hospital to the taxpayer for legal adoption.
4) Court document ordering or approving the placement of a child with the taxpayer for legal adoption.
5) Original affidavit or notarized statement signed under penalties of perjury from an adoption attorney, government official or other person, stating that the signor placed or is placing a child with the taxpayer for legal adoption, or is facilitating the adoption process for the taxpayer in an official capacity.

See Notice 2010-66 for substantiation requirements for the adoption of a special needs child or for foreign adoptions finalized outside the U.S.

Child and Dependent Care Credit

Form 2441; see also IRC §21 and IRS Pub. 503

Taxpayers can claim a nonrefundable credit for a percentage of their dependent care expenses that enable them to work. In 2010, the credit can offset regular tax ~~but not~~ and AMT.

~~**Caution:** For 2009, the credit could offset both regular tax and AMT. At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

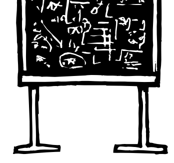
"There are homes in your price range, but location is a problem. You have to go back to 1945."

3) The preparer must make "reasonable inquiries if the information furnished to, or known by, the preparer appears to be incorrect, inconsistent, or incomplete…"
4) The preparer must retain the above information, including a record of how and when the information was obtained and the identity of any person furnishing the information, for three years after the June 30th following the date the return was presented to the taxpayer for signature.

Advance EIC

Taxpayers who are eligible to claim the EIC and have at least one qualifying child can receive part of the credit in their paychecks throughout the year. (IRC §3507)

Caution: The advance EIC is repealed after 2010.



Form W-5, *Earned Income Credit Advance Payment Certificate*, must be completed and given to the employer for each year the taxpayer is eligible.

Advance payments are limited to 60% of the maximum credit for a taxpayer with one qualifying child. Form 1040 or 1040A must be filed to report advance payments received during the year and to receive any additional EIC for which the taxpayer may qualify.

Education Tax Credits

Form 8863; see also IRC §25A and IRS Pub. 970

For 2010, the following education credits are available:

- *American opportunity credit.* An enhanced version of the former Hope credit and only available for 2009 and 2010. **Note:** After 2010, the former Hope credit will be available.
- *Lifetime learning credit (LLC).* Same as in past years.

AMT. The American opportunity credit can offset regular tax and AMT. For 2010, the LLC can offset regular tax, ~~but not~~ and AMT. ~~**Caution:** For 2009, the LLC could offset both regular and AMT. At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Note: See the *Education Tax Incentives Comparison Chart (2010)* on Page 13-5 for more education-related tax breaks.

Who Claims the Credit?

The education credits are available for qualified tuition and/or related expenses of the taxpayer, the taxpayer's spouse or a dependent of the taxpayer claimed on the taxpayer's return. They are not available to married taxpayers filing separate returns. *Exception:* The individual can qualify as unmarried for filing purposes. See *Considered unmarried* on Page 4-8.

Dependent claimed on another person's return. If a parent claims a child as a dependent, only that parent may claim the education credit for the child. If the parent is eligible to, but does not claim the student as a dependent, only the student can claim the education credit. [Reg. §1.25A-1(f)]

Note: This does not change the basic rule that a child cannot claim a personal exemption for himself if the parent is eligible to, but chooses not to, claim the child as a dependent. [IRC §151(d)(2)]

Qualifying expenses paid by a student are considered to have been paid by the parent if the student is claimed as a dependent on the parent's tax return [Reg. §1.25A-5]. Likewise, if the student is not claimed as a dependent, qualifying expenses paid by parent can be claimed by the child. See *Third-party payments* in the next column.

Example #1: In 2010, Ferdinand pays qualified tuition for his son to attend college during 2010. Ferdinand claims his son as a dependent on his tax return. Assuming he meets other requirements, Ferdinand is allowed an education credit on his tax return regardless of who paid the qualifying expenses. His son cannot claim the credit.

Strategy: It may be advantageous for parents who do not qualify for the education credit for their child's expenses due to the AGI limitation to not claim the child as a dependent, so the child (student) can claim the education credit on his return. In that situation, no one claims the dependency exemption.

Third-party payments. If a third party (anyone other than the taxpayer, his spouse or a claimed dependent) pays a student's qualified expenses directly to an eligible institution, the student is treated as receiving the payment from the third party and, in turn, paying the qualified expenses. If the student is not claimed as a dependent on another person's return, the student claims the education credit (if otherwise eligible). If the student is claimed as a dependent on another person's return, the expenses treated as paid by the student are treated as paid by the person claiming the dependency exemption, and that person claims the education credit. [Reg. §1.25A-5(b)]

Example #2: Assume the same facts as Example #1, but Ferdinand chooses not to claim his son as a dependent on his tax return (even though eligible to do so). If Ferdinand's son meets other requirements, he may claim the education credit on his return. The result would be the same regardless of whether Ferdinand or his son paid the qualified expenses. (FSA 200236001)

Qualified Expenses

The following table shows which education expenses qualify for which credits.

Qualified Education Expenses (2010)		
	American Opportunity	Lifetime Learning
Tuition and fees	Yes	Yes[1]
Course-related books, supplies and equipment	Yes[2]	Yes[3]
Room and board	No	No

[1] Includes courses taken to acquire or improve job skills.
[2] Books, supplies and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance.
[3] Must be paid to the institution as a condition of enrollment or attendance.

- Expenses qualify in the tax year paid. Payments must be for an academic period (such as quarter, semester or trimester) that begins either in the same tax year or in the first three months of the following tax year. For institutions that use credit hours or clock hours and not academic periods, each payment period may be treated as an academic period.
- An eligible institution is any accredited college, university, vocational school or other accredited post-secondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education (DOE). This includes certain institutions located outside the U.S. that participate in the DOE programs. An institution should be able to state whether it is eligible. There's also a list at *www.fafsa.ed.gov*. Click on "Search for School Codes."

Qualified expenses do not include:

- Expenses for hobby courses that involve sports, games or hobbies, or any noncredit course unless it is part of the student's degree program. *Exception:* These expenses will qualify for the lifetime learning credit if taken to acquire or improve job skills.

Making Work Pay Credit Phase-Out	
Filing Status	**Modified AGI**
Single, HOH, MFS	$ 75,000 – 95,000
MFJ	150,000 – 190,000
Modified AGI = AGI + excluded foreign earned income and housing costs + excluded income from certain U.S. possessions and Puerto Rico.	

Rules and Definitions

Eligible individuals. An eligible individual is any individual other than: (1) a nonresident alien; (2) an individual who can be claimed as a dependent. An individual is not eligible if he does not include his Social Security number on the return. For joint filers, this requirement is met if the Social Security number of one of the spouses is included on the return.

Earned income. Earned income is the same as for the earned income credit (see *Earned Income Credit* on Page 12-6) with two modifications: (a) it does not include self-employment earnings which are not taken into account in computing taxable income and (b) it includes nontaxable combat pay.

Coordination with economic recovery payment. The credit is reduced by any economic recovery payment received in 2010 by recipients of Social Security, SSI, railroad retirement and Veteran's disability compensation or pension benefits.

Tax Reporting

The Making Work Pay credit is claimed on Form 1040, Schedule M and carried to line 63 of Form 1040.

Residential Energy Tax Credits

Form 5695; see also IRC §25C and §25D and IRS Pub. 17

See Tab O of the *Small Business Quickfinder® Handbook* for energy tax incentives for businesses.

Personal Energy Property Credit

Taxpayers can claim a credit for certain home improvements placed in service in 2009 and 2010 (IRC §25C). This credit for personal energy property was also available for qualifying improvements placed in service in 2006 and 2007, but not in 2008.

Allowable credit:

- The credit is equal to 30% of the cost of qualified energy-efficient property or improvements.
- The total amount of credit that can be claimed in 2009 and 2010 combined is $1,500.
- There are no AGI or income limits so all individuals can claim the credit.
- For 2010, the credit can offset regular tax ~~but not~~ and AMT. ~~**Caution:** For 2009, the credit could offset both regular tax and AMT. At the time of publication, Congress was considering legislation that would extend this provision to 2010. See *Tax Extenders Legislation* on Page 17-1.~~
- The credit is reported on Part I of Form 5695, *Residential Energy Credits*.

Observation: Other than the overall $1,500 (aggregate) credit limit, there are no limits on the amount allowed for specific types of property, as there were in 2006 and 2007. In addition, claiming a credit in 2006 or 2007 does not impact the ability to claim the full $1,500 credit in 2009 and 2010.

Qualifying property. See the *Personal Energy Property Credit—Qualifying Property (2010)* table below for descriptions of property that qualifies for the credit. The property must be installed on or in the taxpayer's principal residence that is located in the U.S. (new construction, vacation and rental homes don't qualify). The improvement must be new (not used) property

Qualifying property must meet technical requirements related to energy savings. Taxpayers are not required to determine whether these requirements are met. Instead, a manufacturer's certification statement (that the property meets the technical requirements) generally is required to claim the credit.

Observation: For 2009 and 2010, qualifying property is slightly different that what qualified in 2006 and 2007. The changes include the addition of biomass fuel stoves and asphalt roofs (with appropriate cooling granules) and the removal of geothermal heat pumps (which now qualify for the residential energy efficient property credit discussed on Page 12-13). Also, the technical requirements regarding energy efficiency for many types of property have been updated.

Property used partly for business. If the home is used partly for business (for example, a home office), any qualified expenditure must be allocated between nonbusiness and business use if the improvement is used more than 20% for business. If allocation is required, only the portion of the expenditure allocated to nonbusiness use qualifies for the credit.

Personal Energy Property Credit—Qualifying Property (2010)	
Summary: (1) equals 30% of cost of qualified property, (2) $1,500 limit (2009 and 2010 combined) and (3) taxpayer's main home only.	
Product	**Energy Requirements**
Advanced Main Air Circulating Fan[1]	Must use no more than 2% of the furnace's total energy.
Air Source Heat Pump[1]	• Split systems: HSPF ≥ 8.5; EER ≥12.5; SEER ≥ 15. • Package systems: HSPF ≥ 8; EER ≥ 12; SEER ≥ 14.
Biomass Stove[1]	Thermal efficiency rating of at least 75% as measured using a lower heating value.
Central Air Conditioning[1]	• Split systems: EER ≥13; SEER ≥ 16. • Package systems: EER ≥ 12; SEER ≥ 14. Not all ENERGY STAR products qualify.
Electric Heat Pump Water Heater[1]	Energy factor ≥ 2.0. All ENERGY STAR qualified electric heat pump water heaters qualify.
Gas, Oil or Propane Hot Water Boiler[1]	AFUE ≥ 90.
Gas, Oil or Propane Water Heater[1]	Energy factor ≥ 0.82 or a thermal efficiency of at least 90%.
Insulation[2]	Must meet 2009 IECC (including supplements) prescriptive criteria. To qualify, its primary purpose must be to insulate. Therefore, insulated siding does not qualify.
Natural Gas or Propane Furnace[1]	AFUE ≥ 95.
Oil Furnace[1]	AFUE ≥ 90.
Roof (Metal and Asphalt)[2]	Metal roofs with appropriate pigmented coatings and asphalt roofs with appropriate cooling granules that also meet ENERGY STAR requirements.
Storm Windows & Doors[2]	In combination with the exterior window/door over which it is installed: has a U-factor and SHGC of 0.30 or below and meets the IECC prescriptive criteria.
Windows and Skylights[2]	U factor ≤ 0.30; SHGC ≤ 0.30.

[1] Installation costs also qualify. [2] Installation costs not included.

SOURCE: *www.energystar.gov*.

Alternative Minimum Tax (AMT)

Form 6251; see also IRC §55–59

The AMT is calculated using a different set of tax rules than those used for regular tax. Under the AMT rules, some deductions taken for regular tax are not allowed (or are limited). Also, certain income and expenses are recognized under different rules for AMT.

If the AMT calculation results in a higher tax than regular income tax, the difference is added to regular income tax on Form 1040. In effect, the taxpayer is liable for either the AMT or regular income tax, whichever is higher.

IRS resource. The *AMT Assistant*—a tool based on the AMT worksheet in the Form 1040 instructions—is designed to help taxpayers determine if they are subject to the AMT. It can be accessed by typing "AMT Assistant" in the search box at *www.irs.gov*.

Alternative Minimum Taxable Income (AMTI)

The starting point for the AMTI calculation is AGI for taxpayers who do not claim itemized deductions, or AGI minus itemized deductions for taxpayers claiming itemized deductions.

To that amount, taxpayers must add or subtract certain adjustments and preferences. See *AMT for Individuals—Adjustments and Preferences* on Page 12-16.

- Adjustments are income or expense items computed differently for AMT and regular tax. They can increase or decrease AMTI.
- Preferences are items that can only increase AMTI.

Both the standard deduction and the deduction for personal exemptions are preferences that are not deductible for AMT. However, they are not reported on Form 6251, because the starting point for computing AMTI on that form is income before the standard deduction and deduction for personal exemptions.

Strategy: Taxpayers who claim the standard deduction for regular tax cannot itemize for AMT. Since the standard deduction is not deducted for AMT, taxpayers who are subject to AMT might save tax by itemizing deductions for regular tax (assuming those deductions are deductible for AMT), even if less than the standard deduction. However, consider any state income tax effect, since many states require taxpayers to use the same method (standard or itemized deductions) for state as they use for federal tax. Elect itemized deductions rather than the standard deduction by filing Schedule A and checking the box on line 30.

AMT NOL. Any NOL deducted to arrive at AGI is added back to AMTI, which is then reduced by the alternative tax NOL deduction (ATNOLD). The ATNOLD is generally limited to 90% of AMTI (figured without regard to the ATNOLD and any Section 199 domestic producer deduction). The instructions for Form 6251 line 12 explain these computations.

Married-filing-separate filers. MFS filers with AMTI above the upper limit of the exemption phase-out range must add to AMTI the lesser of: (1) 25% of the excess of AMTI over that amount or (2) their AMT exemption amount. This amount is added to the total reported on Form 6251, line 29.

AMT Exemption

An exemption is subtracted from AMTI to determine the amount subject to tax.

AMT Exemption Amounts

	2010 ~~See Caution below~~	2009
AMT exemption:		
MFJ or QW	72,450 ~~$45,000~~	$ 70,950
Single or HOH	47,450 ~~33,750~~	46,700
MFS	36,225 ~~22,500~~	35,475
Exemption reduced by 25% of AMTI over:		
MFJ or QW	$ 150,000	$ 150,000
Single or HOH	112,500	112,500
MFS	75,000	75,000
Exemption eliminated at AMTI of:		
MFJ or QW	439,800 ~~$ 330,000~~	$ 433,800
Single or HOH	302,300 ~~247,500~~	299,300
MFS	219,900 ~~165,000~~	216,900

~~**Caution:** 2010 amounts shown will be effective absent action by Congress. However, Congress has temporarily increased the exemption every year since 2001 and is expected to do so again for 2010. See *Tax Extenders Legislation* on Page 17-1. The 2009 amounts shown reflect the temporary increase in effect for that year~~.

Child subject to kiddie tax. A child's exemption amount is the lesser of the exemption for a single taxpayer or the child's earned income plus $6,700 (for 2010).

AMT Tax Rates/Computation

Taxpayers who reported capital gain distributions directly on line 13 of Form 1040, who reported qualified dividends on line 9b of Form 1040, or who had a gain on both lines 15 and 16 of Schedule D (refigured for the AMT) calculate tax in Part III, *Tax Computation Using Maximum Capital Gains Rates*, of Form 6251. Tax rates for capital gains are the same as for regular tax and are applied in the same order (0%, 15%, 25% and 28%). Qualified dividends are also taxed at the same rates for both AMT and regular tax.

All others use AMT tax rates of:

- 26% on amounts up to and including $175,000 ($87,500 MFS).
- 28% on amounts above $175,000 ($87,500 MFS).

Tentative minimum tax (TMT). Once the appropriate tax rate has been applied to AMTI, the amount is reduced by the AMT foreign tax credit to arrive at TMT. See *Simplified AMT foreign tax credit* on Page 12-11.

Alternative minimum tax is the excess of TMT over an adjusted regular income tax.

	Tentative minimum tax (TMT)
–	Regular income tax
+	Tax on lump-sum distributions
+	Foreign tax credit for regular tax
=	AMT. Report on line 45 of Form 1040.

Minimum Tax Credit

Form 8801; see also IRC §53

The minimum tax credit (MTC) is available if the taxpayer paid AMT generated by *deferral items* in a prior year.

AMT adjustments and preferences fall into two categories:

1) *Deferral items.* Items that do not cause a permanent difference in taxable income over time (depreciation, etc.).
2) *Exclusion items.* Items that cause a permanent difference in taxable income (are never deductible or taxable for AMT).

See *AMT for Individuals—Adjustments and Preferences* on Page 12-16.

Continued on Page 12-17

generally must deduct IDC in all subsequent years as it is paid or incurred for all properties. However, he can still make an annual election under Section 59(e) to capitalize and amortize some or all of the IDC incurred that year over 60 months.

- If the Section 263(c) expensing election is not made, IDC is capitalized and recovered through depletion (or depreciation if the cost was associated with transporting or installing physical property).

Dry holes. A taxpayer who does not elect to expense IDC may still elect to expense IDC on nonproductive wells (dry holes). The deduction is allowable only in the year the wells are completed as dry holes [Reg. §1.612-4(b)(4)]. Even when some costs are incurred in one year and the outcome of the well is known by the time that year's tax return is filed, the costs may not be deducted until the year the well is completed.

Practice Tip: For a taxpayer to deduct LHC on dry holes, there must be an identifiable event or point (plugging and abandoning) when the property becomes worthless. Taxpayers do not automatically abandon a lease if a well is dry; therefore, tax preparers should verify with clients that they intend to abandon or not renew the lease before writing off the LHC.

Depreciation. A working interest owner's share of L&WE costs is normally capitalized and depreciated. Often, the majority of an owner's depreciable costs are incurred when a well is determined to be a producing property and pumping and storage equipment is placed in service at the well site. The operator of the well (usually not the working interest owner) determines the character of expenditures as either IDC or capitalizable L&WE. See *MACRS Recovery Periods (2010)* on Page 10-2 for oil and gas asset recovery periods. *Section 179 Deduction* on Page 10-9 also applies.

Domestic producer deduction. A working interest owner qualifies to claim the Section 199 domestic producer deduction (if property is in the U.S.). See Tab 6.

Depletion. A working interest owner is entitled to a deduction for the greater of cost depletion (IRC §612) or allowable percentage depletion (sometimes called statutory depletion—IRC §613A). Cost depletion is based on the property's LHC and is calculated using the mineral reserves (obtained from engineering reports) and the number of units sold for the year [Reg. §1.611-2(a)]. For cash-basis taxpayers, the "number of units sold" means units for which payment was actually received within the tax year.

Cost Depletion Calculation

$$\frac{\text{Unrecovered depletable costs}}{\text{Estimated recoverable reserves (in units) at the beginning of year*}} \times \text{Units sold} = \text{Cost depletion}$$

* Usually obtained from engineering reports.

Practice Tip: For cost depletion, natural gas production is converted into equivalent barrels of oil using a ratio of 6,000 cubic feet to one barrel (or six MCF equals one barrel). [IRC §613A(c)(4)]

Percentage Depletion Quick Facts	
Amount	A percentage of gross receipts from the property.
Rate	Generally 15% for oil and gas properties.
Who Qualifies?	Independent producers (generally working interest owners who are not retailers or refiners) with <1,000 barrels of daily production. Royalty owners are also eligible.
Net Income Limit	Percentage depletion is limited to the net income from each property before any depletion or Section 199 domestic producer deductions. Report income and expenses by property in a supporting schedule to Schedule C. ~~**Caution:** For 2009~~ 2010, the net income limit ~~did~~ does not apply to "marginal production," which is domestic production from a stripper well property or from a property primarily producing heavy oil [IRC §613A(c)(6)]. ~~At publication time, Congress was considering extending this suspension of the net income limit on marginal production to 2010. See *Tax Extenders Legislation* on Page 17-1.~~
65% Limit	A taxpayer's total percentage depletion from all oil and gas properties cannot exceed 65% of taxable income, computed before percentage depletion, NOL and capital loss carryback and Section 199 deductions [IRC §613A(d)]. Deductions denied by this limitation are carried to succeeding tax years.
Not Limited to Basis	Cost depletion stops when LHC is fully depleted. Percentage depletion continues (even after LHC is depleted) because it is based on a percentage of gross income from the property.

Notes

— End of Tab 12 —

- Interest is tax-free if the amount of bonds redeemed (principal plus interest) is less than qualified educational expenses in year of redemption. If redemption amount is more than expenses, the excludable amount is based on the ratio of expenses to redemption amount.
- Married taxpayers filing separate returns are not eligible for the bond interest exclusion, unless an individual is not considered married. See *Considered unmarried* at Page 4-8.
- Exclusion phases out for 2010 when modified AGI is between $70,100 – $85,100 ($105,100 – $135,100 MFJ or QW). Modified AGI is AGI (before the savings bond interest exclusion) increased by: (1) foreign earned income and housing exclusion, (2) foreign housing deduction, (3) exclusion for income from certain U.S. possessions and Puerto Rico, (4) exclusion for employer adoption benefits, (5) student loan interest deduction, (6) domestic production activities deduction and (7) tuition and fees deduction.

The AGI phase-out applies to the year the bonds are redeemed and interest is excluded from income. It does not matter what the bond owner's AGI is in any other tax year.

Student Loan Interest Deduction

See also IRC §221 and IRS Pub. 970

Taxpayers can deduct up to $2,500 of interest paid on qualified education loans for college or vocational school expenses as an adjustment to income (above-the-line) (IRC §221). The deduction is available on qualifying loans for the benefit of the taxpayer or the taxpayer's spouse or dependent at the time that the debt was incurred.

For 2010, the deduction is phased out when modified AGI is between $60,000 and $75,000 ($120,000 and $150,000 MFJ). Modified AGI is AGI (before the student loan interest deduction) increased by: (1) foreign earned income or housing, (2) foreign housing deduction, (3) income from certain U.S. possessions or Puerto Rico, (4) domestic production activities deduction and (5) tuition and fees deduction.

Qualified Loans

Qualified education loans are loans taken out solely to pay qualified education expenses, including tuition, fees, room and board, books, equipment and transportation to attend an eligible educational institution.

Coordination with other education benefits. Qualified education expenses must be reduced by amounts paid with nontaxable education benefits received, such as employer-provided educational assistance, nontaxable distributions from an ESA or QTP, Series EE bond interest education exclusion or veteran's educational benefits.

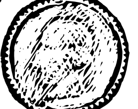
Eligible educational institutions include colleges, vocational schools and other post-secondary institutions that are eligible to participate in Department of Education student aid programs.

Eligible student. Students must take at least one half the normal full-time load in a degree, certificate or other qualified program at an eligible institution.

Restrictions

1) Not available to taxpayers who are claimed as dependents (listed on line 6c of Form 1040) on another taxpayer's return.
2) Not available to married taxpayers filing separately.
3) The taxpayer must have primary obligation to repay the loan and actually pay the interest during the tax year to deduct the interest.
4) Interest on a loan from a related person does not qualify. Related persons include: siblings, spouses, ancestors (parents, grandparents, etc.) and lineal descendants, as well as certain corporations, partnerships, trusts and exempt organizations.
5) Loans from a qualified employer plan [for example, 401(k) plan] do not qualify.

Observation: Because of restrictions 1 and 3, a student loan interest deduction often will not be allowed when the student takes out the loan and his parents claim a dependency deduction for the student/child. *Reason:* If the student has the primary obligation to repay, his parents cannot deduct any interest they pay. Alternatively, if the student pays interest on the loan, he cannot deduct the interest if his parents claim a dependency exemption deduction for him. But, even if a dependency exemption deduction is claimed by the parents for the student/child, it may make sense for the student/child to take out the loan when payments will not be due until after graduation, at which point the child will likely no longer be claimed as a dependent and can therefore, deduct the interest on his return.



Tuition and Fees Deduction

Form 8917; See also IRC §222 and IRS Pub. 970

~~**Caution:** The deduction for tuition and fees expired at the end of 2009 but at the time of this publication, Congress was considering an extension to 2010. See *Tax Extender's Legislation* on Page 17-1.~~

Taxpayers are allowed to claim an above-the-line tuition and fees deduction for qualified higher education expenses paid (IRC §222). The deduction is limited based on the taxpayer's modified AGI.

The deduction is not allowed for MFS filers or for any taxpayer who qualifies as a dependent (whether or not claimed) on another taxpayer's return.

Tuition and Fees Deduction Limit

Deduction Limit*	*If Modified AGI is:*	
	Single, HOH, QW	MFJ
$ 4,000	$ 0 – $ 65,000	$ 0 – $130,000
2,000	65,001 – 80,000	130,001 – 160,000
0	Over $ 80,000	Over $160,000

* Deduction equals qualified expenses, if less.

Note: There is no AGI phase-out range. Thus married taxpayers with $4,000 of qualifying educational expenses and modified AGI of $130,000 or less would be entitled to deduct the full $4,000.

Modified AGI is AGI before the tuition and fees deduction, increased by: (1) foreign earned income and housing exclusion, (2) foreign housing deduction, (3) exclusion for income from certain U.S. possessions and Puerto Rico and (4) domestic production activities deduction.

Qualified Higher Education Expenses

- Tuition and fees required for the enrollment or attendance at an eligible educational institution for the taxpayer, spouse or a dependent. Charges and fees associated with books, supplies and equipment are qualified tuition and related expenses if the fee must be paid to the eligible educational institution as a condition of the enrollment or attendance of the student. [Reg. §1.25A-2(d)(2)]
- Expenses qualify in the tax year paid. Payment must be for education that begins either in the same tax year or in the first three months of the following tax year.
- An eligible institution is any accredited college, university, vocational school or other accredited post-secondary education institution.

Continued on Page 13-6

Education Tax Incentives Comparison Chart (2010)

	American Opportunity Credit	Lifetime Learning Credit	IRA Withdrawals	Savings Bond Interest Exclusion	Student Loan Interest Deduction	Tuition and Fees Deduction ~~Caution: Expired~~[8]	Qualified Tuition Program (QTP)	Education Savings Account (ESA)
IRC §	25A	25A	72(t)	135	221	222	529	530
QF Page	12-9	12-9	14-3	13-3	13-4	13-4	13-6	13-7
Tax Benefit	Tax credit that is 40% refundable.[1]	Nonrefundable tax credit.	10% early withdrawal penalty is waived.	Interest is excludable from income.	Above-the-line deduction.	Above-the-line deduction.	Earnings not taxed (savings plan) or tax-free education credits (prepaid plan).	Earnings not taxed.
2010 Annual Limits	Credit up to $2,500 per student (100% of first $2,000 of expenses and 25% of next $2,000).	Credit up to $2,000 per return (20% of up to $10,000 of expenses).	Amount of qualifying expenses.	Amount of qualifying expenses.	Deduction of up to $2,500 of interest paid on education loan.	Deduction of up to $4,000 of qualifying expenses paid.	Nondeductible contributions limited to amount necessary to cover qualified expenses.	$2,000 nondeductible contribution per child under age 18 and any age special-needs child.
Qualified Education Expenses (QEE)[3]	Tuition and fees; books, supplies and equipment.[2]	Tuition and fees; books, supplies and equipment.[5]	Tuition and fees; books, supplies and equipment;[6] room and board if at least half-time attendance; computer and internet service.	Tuition and fees; book, supplies and equipment;[5] contributions to QTPs and ESAs.	Tuition and fees; books, supplies and equipment; room and board, transportation, other necessary expenses.	Tuition and fees; book, supplies and equipment.[5]	Tuition and fees; books, supplies and equipment;[6] room and board if at least half-time attendance; computer and Internet service.	Tuition and fees; books, supplies and equipment;[6] room and board if at least half-time attendance; payments to QTP; computer and Internet service.
QEE Must Be For	Taxpayer, spouse or dependent.	Taxpayer, spouse or dependent.	Taxpayer, spouse, child or grandchild.	Taxpayer, spouse or dependent.	Taxpayer, spouse or dependent.	Taxpayer, spouse or dependent.	Account beneficiary.	Account beneficiary.
Qualifying Education	First four years of undergraduate.	Undergraduate and graduate.	Undergraduate and graduate.	Undergraduate and graduate.	Undergraduate and graduate.	Undergraduate and graduate.	Undergraduate and graduate.	K–12, undergraduate and graduate.
Other Rules and Requirements	Must be enrolled at least half-time in a degree program; parents can shift credit to student by not claiming student as a dependent.	Available for unlimited number of years for both degree and non-degree programs; parents can shift credit to student by not claiming student as a dependent.	Penalty waived on distributions up to the amount of qualified expenses for the year.	Applies only to qualified Series EE bonds issued after 1989 or Series I bonds; bond owner must be at least 24 years old when bond issued.	Must be enrolled at least half-time in a degree program; loan must be incurred solely to pay qualified education expenses.	Not allowed if education expenses are deducted under another provision or education credit is claimed.	Account owner can change beneficiary or reclaim funds; can elect to spread gift over five years; some states allow deduction to residents; beneficiary can be anyone.	Contributions must be made by the original return due date; may also contribute to QTP; mandatory distributions at age 30; beneficiary can be anyone.
2010 Modified AGI Phase-Out						Not allowed if MAGI exceeds:[4]		
MFJ........................	$ 160,000 – 180,000	$ 100,000 – 120,000	N/A	$ 105,100 – 135,100	$ 120,000 – 150,000	$ 160,000	N/A	$ 190,000 – 220,000
Single, HOH, QW[7]...	80,000 – 90,000	50,000 – 60,000		70,100 – 85,100	60,000 – 75,000	80,000		95,000 – 110,000
MFS.......................	Do Not Qualify	Do Not Qualify		Do Not Qualify	Do Not Qualify	Do Not Qualify		95,000 – 110,000

[1] Not refundable for certain children under age 24. See *American Opportunity Credit* on Page 12-9.
[2] Includes books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment.
[3] Qualifying educational expenses must be reduced by any tax-free scholarships and grants. The same educational expenses cannot be used for figuring more than one benefit.
[4] No AGI phase-out range. Up to $4,000 is deductible if MAGI does not exceed $65,000 ($130,000 for MFJ). Up to $2,000 is deductible if MAGI does not exceed $80,000 ($160,000 for MFJ).
[5] Must be paid to the eligible educational institution as a condition of the students enrollment or attendance at the institution.
[6] Must be required for enrollment or attendance at an eligible educational institution.
[7] For savings bond interest exclusion, QW is subject to the same phase-out range as MFJ.
[8] ~~Expired after 2009; however, at publication time, Congress was considering legislation that would extend the deduction to 2010. See *Tax Extender's Legislation* on Page 17-1.~~

Form 1099-R, Box 7 Distribution Codes	
1	▶Early distribution, no known exception (in most cases, under age 59½).
2	▶Early distribution, exception applies (under age 59½).
3	▶Disability.
4	▶Death.
5	▶Prohibited transaction.
6	▶Section 1035 exchange (a tax-free exchange of life insurance, annuity, qualified long-term care insurance or endowment contracts).
7	▶Normal distribution.
8	▶Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2010.
9	▶Cost of current life insurance protection.
A	▶May be eligible for 10-year tax option (see Form 4972).
B	▶Designated Roth account distribution.
D	▶Excess contributions plus earnings/excess deferrals taxable in 2008.
E	▶Distributions under Employee Plans Compliance Resolution System (EPCRS).
F	▶Charitable gift annuity.
G	▶Direct rollover of a distribution (other than a designated Roth account distribution) to a qualified plan, a Section 403(b) plan, a governmental 457(b) plan or an IRA.
H	▶Direct rollover of a designated Roth account distribution to a Roth IRA.
J	▶Early distribution from a Roth IRA, no known exception (in most cases, under age 59½).
L	▶Loans treated as distributions.
N	▶Recharacterized IRA contribution made for 2010 and recharacterized in 2010.
P	▶Excess contributions plus earnings/excess deferrals taxable in 2009.
Q	▶Qualified distribution from a Roth IRA.
R	▶Recharacterized IRA contribution made for 2009 and recharacterized in 2010.
S	▶Early distribution from a SIMPLE IRA in first two years, no known exception (under age 59½).
T	▶Roth IRA distribution, exception applies.
U	▶Dividend distribution from ESOP under Section 404(k) (not eligible for rollover).
W	▶Changes or payments for purchasing long-term care insurance contracts under combined arrangements.

Box 8. The current actuarial value of an annuity contract (that is part of a lump-sum distribution). This amount will not be included in boxes 1 and 2a.

Box 9a. The percentage received by the person whose name appears on the Form 1099-R (for a total distribution made to more than one person).

Box 9b. For a life annuity from a qualified plan or from a Section 403(b) plan (with after-tax contributions), the employee's total investment in the contract. It is used to compute the taxable part of the distribution.

Boxes 10-15. State and local tax information provided for the recipient's convenience.

Qualified Charitable Distributions (QCDs)

~~**Caution:** The special rule allowing QCDs expired at the end of 2009, but at the time of publication, Congress was considering an extension to 2010. See *Tax Extenders Legislation* on Page 17-1.~~

Taxpayers who have reached age 70½ can make a distribution of up $100,000 directly (by the trustee) from their IRA to a charitable organization. [IRC §408(d)(8)]

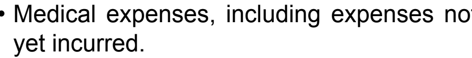
- For joint filers, each spouse can make a QCD of up to $100,000.
- A QCD is nontaxable.
- QCDs are limited to the amount of distribution that otherwise would have been taxable.
- No charitable deduction is allowed for any QCD.
- QCD counts toward a taxpayer's a required minimum distribution.

Note: QCDs made in January 2011 can be treated as occurring on December 31, 2010.

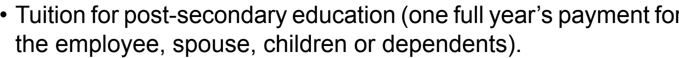
401(k) Hardship Rules

Employees generally cannot withdraw funds from a 401(k) plan until they leave the company. However, employees may qualify to withdraw 401(k) elective contributions before then if there is an immediate and heavy financial need. [Reg. §1.401(k)-1(d)(2)]

Expenses that satisfy the financial need requirement:



- Medical expenses, including expenses not yet incurred.
- Purchase of principal residence.



- Tuition for post-secondary education (one full year's payment for the employee, spouse, children or dependents).
- To prevent eviction or to halt a mortgage foreclosure on the taxpayer's principal residence.
- Amounts to cover anticipated federal and state income taxes, plus early withdrawal penalties due to the hardship distribution.
- Cost of burial or funeral expenses for the employee, parent, child or other dependent.
- Certain expenses relating to the repair of damage to the employee's principal residence that qualify for the casualty loss deduction without regard to whether loss exceeds 10% of AGI.

Note: A plan that permits hardship distributions may include distributions for medical, tuition and funeral expenses for a primary beneficiary under the plan (even if not a spouse, child or dependent of the employee) (Notice 2007-7). In addition, a hardship of the employee's spouse or dependent is deemed to constitute a hardship of the employee.

Tax treatment. There are no income tax or penalty exceptions specifically for hardship withdrawals. Thus, they are taxable and subject to a 10% penalty, unless a penalty exception applies. See the *Exceptions to 10% Early Withdrawal Penalty Before Age 59½* on Page 14-3 for exceptions to the 10% penalty.

Required Minimum Distributions (RMDs)

See also Reg. §1.401(a)(9)-0 through -9, Reg. §1.408-8 and IRS Pub. 590

Annual minimum distributions from traditional IRAs, SIMPLE IRAs and SEP IRAs must begin starting for the year the taxpayer reaches age 70½. Taxpayers can choose to delay receipt of the first distribution until April 1 of the year following the year they turn 70½. Thereafter, the RMD for each year must be made by December 31. If the first distribution is delayed until April 1 of the following year, the second distribution must be made by December 31 of that year.

Like RMDs from IRAs, RMDs from qualified employer plans generally must begin for the year the individual reaches age 70½. However, RMDs can be delayed until the year the individual retires from the employer if he continues to work past age 70½. However, this RMD exception doesn't apply to participants who are more-than-5% owners of the business sponsoring the qualified plan. [IRC §401(a)(9)(C) and Reg. §1.408-8, Q&A-2]

Social Security Topics

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Disability Benefits... Page 14-26
Medicare .... Page 14-27
Medigap Insurance .... Page 14-29
Medicaid... Page 14-30
Supplemental Security Income .... Page 14-30

Social Security and Medicare Highlights			
	2011	**2010**	**2009**
Cost-of-living (COLA) adjustment	0.0%	0.0%	5.8%
Maximum earnings and still receive full benefits:			
Under full retirement age (FRA) at year-end	$ 14,160	$ 14,160	$ 14,160
Year FRA reached[5]	37,680	37,680	37,680
Month FRA reached and later	No Limit	No Limit	No Limit
Maximum earnings subject to:			
Social Security tax	$ 106,800	$ 106,800	$ 106,800
Medicare tax	No Limit	No Limit	No Limit
Rate of tax: [1, 2]			
Social Security	~~12.4~~ 10.4%	12.4%	12.4%
Medicare	2.9	2.9	2.9
Maximum tax paid by:			
Employee			
Social Security	$ ~~6,621.60~~ 4,485.60	$ 6,621.60	$ 6,621.60
Medicare	No Limit	No Limit	No Limit
Self-Employed [3]			
Social Security	$~~13,243.20~~ 11,107.20	$13,243.20	$13,243.20
Medicare	No Limit	No Limit	No Limit
Earnings needed to earn one quarter of coverage	$ 1,120	$ 1,120	$ 1,090
Medicare:			
Part A monthly premium[4]	$ 450.00	$ 461.00	$ 443.00
Part B monthly premium[6]	96.40	96.40	96.40
Hospital deductible	1,132.00	1,100.00	1,068.00
Medical deductible	162.00	155.00	135.00

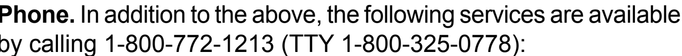
[1] Employees pay 50% of the rate shown.
[2] Self-employed individuals pay 100% of the rate shown.
[3] Does not reflect special deductions for self-employed individuals.
[4] Cost for those ineligible for Social Security benefits. Lower premium if 30–39 quarters of covered employment.
[5] Limit applies only to months before attaining FRA. See *Earnings May Reduce Benefits* on Page 14-25.
[6] Beneficiaries with higher incomes or who did not have premiums withheld by the SSA pay a higher premium. See *Medicare* on Page 14-27.

Exception: For 2011, employee's Social Security tax rate is 4.2%.

Contacting the Social Security Administration (SSA)

Online. The following services are available at *www.ssa.gov*:

- Apply for Retirement, Disability or Spouse's Benefits,
- Apply for help with Medicare prescription drug costs,
- Request a Social Security Statement (or replacement),
- Request a replacement Medicare Card,
- Request a Benefit Verification Letter,
- Figure retirement, disability or survivors benefits,
- Subscribe to eNews, an email newsletter,
- Find Social Security forms,
- Find the nearest Social Security office,
- Find Social Security publications and
- Change address or telephone number.



Phone. In addition to the above, the following services are available by calling 1-800-772-1213 (TTY 1-800-325-0778):

- Request an application for a replacement Social Security card (Form SS-5, *Application for a Social Security Card*),
- Correct the name on a Social Security record (proof of identity or other documentation may be required at the local office),
- Have Social Security benefits sent directly to a bank account,
- Discuss the rules for getting Social Security benefits,
- Ask questions about a check or report a missing check,
- Report a death,
- Discuss the amount of an overpayment,
- Set up a plan for repaying an overpayment,
- Ask to repay an overpayment in installments,
- Ask SSA to waive an overpayment,
- Discuss Representative Payee situations,
- Request an appointment at a Social Security office or
- Get phone numbers for other government agencies.

If additional services are needed, check the Field Office Locator at *www.ssa.gov* for the nearest office.

Social Security Statement

Social Security Statement is a concise, easy-to-read personal record of the earnings on which an individual has paid Social Security taxes during his working years and a summary of the estimated benefits he and his family may receive as a result of those earnings. Statements are automatically sent annually to workers ages 25 and older, and provide an estimate of benefits along with a complete earnings history. Individuals may also file Form SSA-7004, *Request for Social Security Statement*, by mail or request the statement online from the SSA's website.

The form asks for name, Social Security number, date of birth, previous year's earnings, estimate of current year's earnings, planned age of retirement and projected annual earnings until retirement.

Estimating Social Security benefits. An estimate of Social Security benefits can be found on the Social Security Statement or online at *www.ssa.gov/planners/calculators.htm*. There are calculators that estimate potential benefit amounts using assumptions about retirement dates and different levels of potential future earnings. The calculators show retirement benefits as well as disability and survivor benefit amounts.

Financial Planning **starts on Page 15-14.**

Estate Planning

Tab 15 Estate Planning Topics

Quick Facts on Estate Planning .... Page 15-2
Filing Income Tax Returns for Decedent (Form 1040) .... Page 15-2
Estate Distributions and Schedule K-1 (Form 1041)................ Page 15-4
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Planning for Illness/Disability .... Page 15-8
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Related Information

Small Business Quickfinder® Handbook:

- Estate Inventory Worksheet—Tab A
- Worksheet to Reconcile Income Reported on Final Form 1040 and Form 1041—Tab A
- Fiduciary Tax Returns—Tab G
- Estate and Gift Tax Returns—Tab H

Tax Planning for Individuals Quickfinder® Handbook:

- Estate and Gift Tax—Tab 15

IRS Publication 559, *Survivors, Executors and Administrators*.

Federal Estate and Gift Tax Rates

For gifts made and estates of decedents dying in 2010

—Quick Tax Method—

At the time of publication, the estate tax was repealed for 2010 so estates of decedents dying in 2010 are not subject to estate tax. However, tax preparers should [illegible] rules for 2010. [illegible] the [illegible]

Updated tables available—see *1040 Quickfinder Handbook (2010 Tax Year)* in the Updates section of *Quickfinder.com*

Year	Top Bracket (Taxable Amount)		Top Rate				Tax
2007 – 2009	$ 1,500,001 and over	×	45%	minus	$ 119,200	=	Tax
2010	Estate Tax Repealed —*Gift Tax Only*— $ 500,001 and over	×	35%	minus	$ 19,200	=	Tax

Estate and Gift Tax Credit/Exclusion

Estate Tax		
For Transfers Made in:	**Credit**	**Exclusion**
1987–1997	$ 192,800	$ 600,000
1998	202,050	625,000
1999	211,300	650,000
2000–2001	220,550	675,000
2002–2003	345,800	1,000,000
2004–2005	555,800	1,500,000
2006–2008	780,800	2,000,000
2009	1,455,800	3,500,000
2010	N/A	N/A
2011	345,800	1,000,000

Gift Tax		
[illegible]	[illegible]	**Exclusion**
[illegible]	[illegible]	$ 600,000
[illegible]	[illegible]	625,000
[illegible]	[illegible]	650,000
[illegible]	[illegible]	675,000
[illegible]	[illegible]	1,000,000
[illegible]	[illegible]	1,000,000
2011	345,800	1,000,000

Note: At the time of publication, the estate tax was repealed for decedents dying in 2010, but is scheduled to be reinstated in 2011 with the rules that were in effect in 2001. See *Estate Tax* on Page 17-1.

Income Tax on Inheritance

Inheritance:

– These rules apply to property passing from a decedent, including assets that pass through probate, as well as assets inherited directly by joint tenants, pay-on-death designees and beneficiaries. Beneficiaries of taxable items generally report taxable income when they receive the income.
– These rules may not apply to an asset if the decedent completed a gift of the asset before death.

Taxable	Not Taxable
• Annuities (except decedent's investment in the contract).	• Life insurance proceeds.
• Investment income paid after death.	• Cash, bank accounts, CDs.
• Payments from employer—wages, salaries, bonuses, commissions, back pay, vacation pay, sick pay.	• Stocks, bonds, mutual funds.*
• Contracts for deed and other installment sales (gross profit percentage).	• House, cabin, other real estate.*
• Series EE bond interest accrued through date of death unless decedent included interest in income ratably or elected to include all accrued income in final return.	• Cars, vehicles, household goods, jewelry, other personal property.*
• Traditional IRAs (except nondeductible contributions), deferred compensation, qualified pension plans, profit-sharing plans, Keoghs.	• Roth IRA held more than five tax years.
• Accounts receivable.	• Payment from a probate estate of a sum of money or other property specifically described in a will.

* Value on date of death generally is not taxable because basis steps up or down to FMV as of that date; however, see *Basis of Inherited Property* on Page 15-5 for special rules that apply to property inherited from decedents who died in 2010.

Funeral, probate and other estate expenses are deductible on Form 706 but not on Form 1040.

If liability for deductible expenses passes to the estate or other beneficiary as a result of transferring property or income rights belonging to the decedent, these expenses may be deductible by the estate or beneficiary.

Standard Deduction and Personal Exemption

The standard deduction and personal exemption can be claimed in full as if death had not occurred. However, the higher standard deduction for age is not allowed unless the decedent was 65 or older at the time of death. A decedent cannot use the standard deduction if the surviving spouse files separately and itemizes. The decedent cannot claim the personal exemption if someone else can claim the decedent as a dependent.

Credits

Any credits that applied to the decedent before death can be claimed on the decedent's final return. An earned income credit (EIC) may be claimed even if the decedent's return covers only a partial year and the decedent would not have qualified with a full year's income. A decedent's EIC is refundable.

Headings

Write "DECEASED," the decedent's name and the date of death across the top of the tax return.

Joint return. Write the names, addresses and Social Security numbers of the decedent and surviving spouse as usual.

Not joint return. Write the decedent's name in the name space and the name and address of the person filing the form in the remaining space.

Signing Forms

Estate representative. If there is a court-appointed representative, he must sign the return and include his title. If a joint return is filed, the representative signs for the decedent and the surviving spouse signs as usual in the space for his signature. If the spouse is also the representative, he should sign the return twice; the words "Filing as Surviving Spouse" should not be written on the signature line.

Surviving spouse. If there is no estate representative, write "Filing as Surviving Spouse" in the space for decedent's signature. The surviving spouse signs in the space for his signature.

Person in charge of decedent's property. Sign name followed by the words "Personal Representative."

Documents Needed to Claim a Refund

If the tax return shows a refund, Form 1310 or other documentation may be required, depending on who files and signs the return.

Estate representative. If there is a court-appointed representative, a certificate showing the appointment must be attached to the return (usually Letters Testamentary or Letters of Administration). Form 1310 is not required if the representative is filing an original return. Form 1310 is required if a refund is claimed on an amended return. A copy of a will cannot be attached in place of the court certificate. The executor or representative named in a will has no authority over the estate until appointed by a court. If probate is not required, the named representative never receives court authority and is considered a person in charge of the decedent's property.

Surviving spouse. If there is no court-appointed representative and a joint return is filed by the surviving spouse, no additional documentation is required.

Deceased Taxpayer—Tax Returns

Tax Return	IRS Form	Due Date	Return required if:	More Information
Final Income Tax Return	1040	April 15 of the year following death[1]	• The decedent's gross income from January 1 through the date of death exceeds the filing floor for the decedent's filing status and age determined on the date of death or • The decedent meets any other filing requirements for individuals (such as SE income). • To claim a refund or refundable credit.	• *Filing Income Tax Returns for Decedent (Form 1040)* on Page 15-2. • Tab 4 for filing requirements.
Income Tax Returns for Preceding Years	1040	April 15 of the year of death[1]	The decedent dies after the end of the year but before filing, and the decedent met any of the filing requirements for individuals. Original or amended returns for back years must also be filed if the decedent would have been required to file. Amended returns may be filed to claim refunds.	• *Filing Income Tax Returns for Decedent (Form 1040)* on Page 15-2. • See Tab 3 for prior-year filing requirements.
Fiduciary Income Tax Return	1041	15th day of the fourth month following the close of the tax year	• Estate had gross income of $600 or more in the tax year or • Estate has a nonresident alien beneficiary. A return can be filed to pass deductions to beneficiaries in the estate's final year. **Notes:** – Gross income includes proceeds from the sale of decedent's home or other capital asset if paid to the probate estate. – If decedent was the grantor of a revocable trust, Form 1041 may be required to report trust income.	• Tab G of the *Small Business Quickfinder® Handbook* for information on preparing fiduciary returns. • *Revocable Living Trusts* on Page 15-12.
Estate Tax Return[2]	706	Nine months after the date of decedent's death [3]	The decedent's gross estate at death plus taxable lifetime gifts exceeds the applicable exclusion amount. [IRC §6018(a)] **Note:** Gross estate includes amounts qualifying for the charitable and marital deductions.	• *Estate and Gift Tax* on Page 15-8 for information on assets included in the gross estate.
Gift Tax Return	709	Earlier of: • April 15 of the year following gift or • Form 706 due date	• The decedent made a taxable gift in the year of death. • The decedent made a taxable gift in the year preceding death and died before filing. • The decedent failed to file a required prior year return.	• *Gifts and Gift Tax Returns* on Page 15-10. • Tab H of the *Small Business Quickfinder® Handbook* for information on preparing Form 709.

if executor chooses to be exempt from estate tax

[1] For calendar-year taxpayers. The due date is the same date the decedent's return would have been due had death not occurred.

[2] Estates of decedents dying in 2010 are not required to file Form 706 ~~since the estate tax was repealed for 2010~~. However, such estates may be required to file an information return (which the IRS had not issued at the time of publication) to allocate the allowable basis increase under the modified carryover basis rules (see *Basis of Inherited Property* on Page 15-5 for more information).

[3] No earlier than nine months after 12/17/10 for decedent who died any time from 1/1/10–12/16/10.

Probate

Probate generally refers to the court procedures for validating a will and passing ownership of property from a decedent to others. Most states offer a simplified probate, allowing many estates to be probated informally with minimal court supervision.

Probate and Nonprobate Assets

Nonprobate assets transfer automatically to the new owners at death. A state court must authorize transfer of probate assets.

Probate Assets	Nonprobate Assets
• Assets owned individually by the decedent. • The decedent's share of assets owned as a tenant in common or as community property. • Life insurance, annuities and retirement assets without beneficiary designations. • Life insurance, annuities and retirement assets if the estate is the named beneficiary or if the estate receives the asset because the named beneficiaries are deceased or disclaimed their interests.	• Assets owned jointly with right of survivorship. • Life insurance, annuities and retirement assets with beneficiary designations other than the estate. • Bank accounts and other assets with "pay on death" or trust designations. • Securities or security accounts to be "transferred on death." • Assets in trust if instrument includes a plan for distribution after death.

When Probate Is Required

In most states, probate is required when a decedent's probate assets exceed a threshold amount, generally $20,000 to $100,000. Estates with probate assets under the state's threshold do not need to be probated, even if the total estate is worth millions. When probate is required, nonprobate assets are not included in the proceeding. However, probate may be required if the decedent had sole guardianship or custody of a minor child.

If there is a will, is probate required? Yes, if the probate assets exceed the threshold amount. Making a will does not avoid probate. A will allows the decedent to name the representative of the estate, nominate a guardian for minor children and determine who will receive property. In the absence of a will, these decisions are made according to state law.

If there is a surviving spouse, is probate required? Yes, if the probate assets exceed the threshold amount. The estate of the first spouse to die will not require probate if the couple owned all assets jointly and there are few, if any, probate assets.

Small estates—collection of property by affidavit. Although estates under a state's threshold do not need to be probated, ownership of the probate assets will not pass automatically. Many states allow these assets to be claimed by affidavit. Commonly, the successors (those entitled to property either by will or under the state's intestacy laws) prepare a sworn statement that the estate is under the filing threshold and they are entitled to the property. Third parties are generally allowed to transfer assets to the successors without verifying the facts in the affidavit. Legal title passes directly from the decedent to the successors.

Basis of Inherited Property

Decedent Died in 2010

Caution: This section discusses the rules in effect for 2010 at the time of this publication. Tax preparers should monitor Congressional action for possible changes.

The stepped-up basis rules ~~are repealed~~ do not apply for property acquired from decedents dying in 2010 if executor chooses to be exempt from estate tax [IRC §1014(f)]. In their place, a modified carryover basis system applies so that the tax basis of property acquired from the decedent is the lesser of: (IRC §1022)

1) The decedent's adjusted basis (with limited step-up—see *Limited step-up basis increase* below) or
2) The FMV of the property at the date of death.

Limited step-up basis increase. The estate's executor can allocate to certain appreciated property an aggregate basis increase of up to $1.3 million [IRC §1022(b)]. The $1.3 million is increased by the amount of the decedent's unused NOL and capital loss carryovers as well as certain "built-in" losses as of the date of the decedent's death. The basis of any property cannot be increased above its FMV at the date of death.

An additional $3 million spousal property basis increase is available for outright transfers or qualified terminal interest property (QTIP) transferred to a surviving spouse. If community property, the surviving spouse's half interest in the property is eligible for the spousal basis increase.

Note: The allowable basis increase cannot be allocated to income in respect of a decedent (IRD) property, such as retirement accounts and installment notes (with unrecognized gains).

Information reporting requirement. Executors must file an information return if the decedent's property (other than cash) exceeds $1.3 million or if the decedent acquired certain property by gift within three years of death (IRC §6018). The information return will be used to report the carryover basis of the decedent's property and the allocation of the basis increase under the new basis rules. Failure to file may result in a penalty of $10,000.

Note: At the time of this publication, the IRS had not yet released the new information return. The return will be due with the decedent's final income tax return (or later if specified in regulations). [IRC §6075(a)]

Executors also are required to provide each beneficiary a written statement that lists the information reported on the information return with respect to the property the beneficiary acquired from the decedent. This statement is due within 30 days of filing the estate information return. Failure to provide the statements may result in a penalty of $50 for each failure.

Decedent Died Before or After 2010*

The basis of property acquired from a decedent who died before or after 2010 is generally the value placed on the property for federal estate tax purposes:

1) FMV on the date of the decedent's death,
2) FMV on the alternate date if an estate tax return is filed and alternate valuation is elected (see *Alternate valuation date* on Page 15-8) or
3) Value based on actual use if an estate tax return is filed and special-use valuation is elected.

Property acquired from a decedent includes property received from the decedent's estate, property passing to a surviving joint tenant or pay-on-death designee, property held by the decedent in a revocable trust, and any other property that must be included in the decedent's gross estate for estate tax purposes [IRC §1014(b)]. A remainder interest following the decedent's life estate is acquired from a decedent if the decedent owned the entire property before transferring the remainder. [IRC §2036 and §1014(b)(9)]

This change of basis is commonly referred to as *stepped-up* basis, although the rule can also result in stepped-down basis if the value of an asset at death is lower than the decedent's basis. Stepped-up (or stepped-down) basis rules apply even if the estate is not required to file an estate tax return or pay estate tax. Survivors of decedents with small estates and appreciated assets get the benefit of stepped-up basis without the corresponding estate tax liability.

* and 2010, unless executor chooses to be exempt from estate tax

Tips on Handling a Will

- Consult an attorney. Although wills written without legal advice are generally valid, an attorney can help ensure that the will actually accomplishes the testator's objectives and that the language does not invite a probate battle.
- If a lawyer is not used, know the requirements for witnessing and executing valid wills in the state. Follow them precisely. A will is more likely to be invalidated for mistakes in execution than for mistakes in writing.
- Store the original will in a secure place, such as a safe deposit box, home safe or with an attorney or county probate court. Inform a few trusted friends or family members of the location of the will so it can be found when needed.
- Review the will periodically. Do not write changes on an existing will or it may be invalidated. To make small changes, sign a formal codicil following the state's rules for witnessing and executing wills. To make substantial changes, execute a new will.
- If the testator moves from one state to another, have the will reviewed by an attorney in the new state to make sure the will is valid under the new state's laws.
- Include contingent beneficiaries in the event the primary beneficiary does not survive or a couple dies simultaneously.

Prenuptial and Postnuptial Agreements

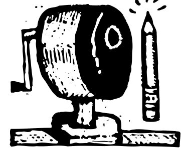
Many states have laws preventing one spouse from disinheriting another and generally allow the surviving spouse a share of the couple's estate regardless of the form of ownership of their assets and terms of their wills. Prenuptial and postnuptial agreements limit one spouse's stake in property owned by the other. They generally determine rights in the event of divorce or death. In most states, valid agreements require that each party have a separate lawyer and that both make full financial disclosure.

Planning for Illness/Disability

Estate Planning Goal	Alternatives
Financial management during disability	• Durable power of attorney. • Revocable trust. • Court-supervised guardianship or conservatorship.
Health and personal care during disability	• Health care power of attorney or proxy, living will and other advanced directives. • Decision left to family members. • Court-appointed guardian.

When people become incapacitated, court-appointed guardians may be needed to manage financial affairs, liquidate assets to pay bills and make personal and health care decisions. Guardianship proceedings are expensive and require the guardian to account to the court annually for the duration of the guardianship. Arrangements made in advance of incapacity can help avoid the need for a court-appointed guardian.

Financial Affairs



Power of attorney. Document that allows one person (principal) to authorize another (attorney-in-fact) to act on the first person's behalf. Powers given to the attorney-in-fact depend on the type of form signed. Powers may be listed in the document, or the document may refer to a state statute that describes the powers. Many states have a statutory form—a standard form contained in their laws.

For disability planning, a power of attorney must be durable. A "durable" power contains a statement that the power will be effective even if the principal becomes incapacitated or incompetent. Durable powers end at death unless the document contains an expiration date or the principal revokes the power.

An attorney-in-fact can sign federal tax returns if the principal is unable to sign because of disease or injury or a continuous absence from the United States for 60 days prior to the filing deadline. A non-IRS form is acceptable if it contains the power to handle tax matters. Attach the power of attorney to the return or Form 8453. The IRS may require that the non-IRS form be perfected before releasing information to the attorney-in-fact. See IRS Pub. 947, *Practice Before the IRS and Power of Attorney*, for procedures.

Living trusts. Most trusts allow a successor trustee to manage the trust when the grantor is incapacitated. A successor has easy access to assets inside the trust, but a power of attorney may also be needed for issues that do not involve trust assets.

Health Care

Health care power of attorney. A principal can appoint an agent to make health care decisions when he is unable to decide or communicate. These powers can be included in a financial power of attorney or contained in a separate document.

Living will. A living will is a statement of instructions for health care when a person reaches a terminal condition. Living wills are generally used to limit life-sustaining treatment. Because living wills generally become effective only in a terminal condition, living will instructions are sometimes written into health care powers of attorney, although many attorneys recommend separate documents.

Estate and Gift Tax

See Tab H of the Small Business Quickfinder® Handbook for information on how to prepare Form 709

Federal Estate Tax

~~**Note:** The estate tax is repealed for 2010 so much of the discussion in this section does not apply to 2010 (see *Estate tax repealed for 2010 only* on Page 15-9). However, it does apply to estates of decedents who died before 2010 and to those who die in 2011 and later years.~~

The federal estate tax is a tax on transfers of property at death.

An estate tax return (Form 706) must be filed if the decedent's gross estate at death plus taxable lifetime gifts exceed the applicable estate tax exclusion amount for the year of death [IRC §6018(a)]. The gross estate includes all property owned by the decedent at the time of death—cash, investments, real estate, vehicles, personal property, life insurance proceeds from policies owned by the decedent within three years of death, life insurance paid to the estate, retirement assets and business interests. The gross estate includes assets passing through probate as well as assets inherited directly by joint owners or beneficiaries. It includes partial interests, intangible property, property placed in a revocable trust and other interests transferred by a decedent who retained control or an interest in the property.

Alternate valuation date. Normally, the value of the gross estate is determined as of the date of the decedent's death. However, the personal representative may instead elect to value all assets at their value as of the alternate valuation date, which is six months after the date of death, if the gross estate and the sum of the estate's liability for estate and generation-skipping transfer (GST) tax payable is decreased as a result of the election [IRC §2032(a) and (c)]. The primary benefit of electing the alternate valuation date is the estate (and possibly GST) tax savings that results from lowering the overall value of the property included in the estate. (Note that no alternate valuation date exists for federal gift tax purposes.)

Calculating federal estate tax. The estate can deduct its funeral expenses, administration expenses, claims paid (including decedent's debts) and losses. With a few minor exceptions, the estate is allowed to deduct the entire amount of property passing to qualified charities and to a surviving spouse.

Example: Ralph dies in 2009 with a gross estate of $7.9 million. After considering his allowable deductions and prior gifts, his estate tax is $1,971,000, calculated as follows:

Total gross estate	$ 7,900,000
Less allowable deductions	< 36,000 >
Taxable estate	$ 7,864,000
Plus cumulative taxable gifts	16,000
Total	$ 7,880,000
Tentative tax on total	$ 3,426,800
Less gift tax paid by decedent	< 0 >
Gross estate tax	$ 3,426,800
Less applicable credit (death in 2009)	< 1,455,800 >
Net estate tax	$ 1,971,000

All taxable gifts made by the decedent during life are added to the gross estate and the final estate tax liability is calculated on the total. The estate receives credit for gift tax paid (recalculated using year of death rates) by the decedent and an estate tax credit base on the year of death.

Estate tax ~~repealed~~ for 2010 only. The estate tax ~~is repealed for~~ decedents who die in 2010. Therefore, there is no need to file Form 706. However, executors may be required to file an information return with the IRS to report basis increase for certain property owned by the decedent (see *Decedent Died in 2010* on Page 15-5).

Caution: Although there is no federal estate tax return required ~~for~~ decedents dying in 2010, there may be state inheritance or estate tax returns that must be filed.

~~Th[illegible] 2010, with an applicable estate exclusion amount of $1 million and a maximum rate of 55%.~~

~~**Note:** At the time of this publication, it is expected that Congress will enact legislation that will change the estate tax rules for 2011 and later. It's also possible that legislation could affect 2010. Tax preparers should watch for Congressional action with regard to the estate tax.~~

Federal Gift Tax

The federal gift tax is a tax on lifetime transfers of property or property interests made without adequate consideration.

Federal estate and gift taxes are integrated. One set of rates is applied to the cumulative transfers made by a taxpayer during life and at death. The tax is imposed on the person transferring property rather than on the recipients, although the IRS can collect a decedent's unpaid tax from those receiving property.

Every taxpayer is allowed exclusions from gift and estate tax before the tax is imposed. The gift tax exclusion is $1 million. The estate tax exclusion was $3.5 million for decedents dying in 2009. For 2010, the estate tax is repealed, but the gift tax is not repealed.

A gift tax return (Form 709) must be filed if a taxpayer makes any taxable gifts in the calendar year. *Taxable gifts* are generally amounts over $13,000 (for 2010) given to someone other than a spouse or charity. Although tax is calculated on the return, no tax is due until the taxpayer exhausts the $1 million gift tax exclusion.

Each year that a gift tax return is filed, gifts made in all prior years must be reported on the return. Gift tax is calculated on the cumulative total. The tax due is the difference between the tax on the cumulative total and the tax on gifts made in prior years, less any remaining allowable credit.

Annual gift tax exclusion. A taxpayer can give $13,000 (for 2010) per person to any number of recipients in a calendar year without paying federal estate and gift tax. Gifts that qualify for this annual exclusion are never taxed—no gift tax is owed when the gift is made, and the gift is not added back to the taxable estate at death. If a gift is over $13,000 (for 2010), only the excess is a taxable gift.

The annual exclusion is indexed for inflation and will change again when cost of living adjustments reach the next $1,000 multiple.

To qualify for the annual exclusion, a gift must be a present interest—the recipient must have all immediate rights to the use, possession, enjoyment and income of the property. The annual exclusion does not apply to a future interest—the recipient's rights to benefit from the property begin at some future date. Most gifts to trusts do not qualify for the exclusion because they are gifts of future interests. Exceptions include gifts to a minor's trust and gifts to a trust that includes a Crummey Power (see *Crummey Power in Trust Document* on Page 15-13).

Gifts from married couples. See *Returns for married couples* on Page 15-10 for special rules that apply to gifts made by married couples.

Qualified transfers—tuition and medical care. Direct payment of medical expenses or tuition for another person is not a gift for gift tax purposes [IRC §2503(e)]. Payment must be made to the school or medical provider and not to the beneficiary. Qualified transfers are not reported on Form 709. Payments for books, supplies, dormitory fees and board do not qualify. Tuition for part-time students qualifies. Medical payments can cover any type of expense deductible for income tax purposes, including payment of insurance premiums. The beneficiary of a qualified transfer does not need to be related to the taxpayer. In addition, an annual exclusion gift can be made to the beneficiary of a qualified transfer.

Political transfers. A transfer to a political organization as defined in Section 527(e)(1) for use by the organization is not a taxable gift and does not need to be reported on a gift tax return. [IRC §2501(a)(4)]

Marital Deduction

Most transfers to a spouse qualify for the marital deduction and pass to the spouse tax-free. Gifts that fully qualify for the deduction do not need to be reported on a gift tax return (unless they qualified because of a QTIP election as discussed below). For years other than 2010, transfers to a surviving spouse at death must be reported on Form 706 but are generally fully deductible on the estate tax return.

Exceptions:

- *Noncitizen.* Generally, gifts to a noncitizen spouse do not qualify for the marital deduction. Such gifts qualify for an annual exclusion of $134,000 (for 2010) if the gifts that exceed $13,000 (for 2010) would qualify for the marital deduction if given to a citizen spouse. [IRC §2523(i)]
- *Certain Terminable Interests.* A terminable interest is one that ends at death or on the occurrence of some other specified event (life estates, annuities, income interest in a trust, etc.). Generally, a gift of a terminable interest does not qualify for the marital deduction if the donor also gave an interest in the property to a third person who will possess or enjoy the property after the spouse's interest ends [IRC §2523(b)(1), §2056(b)(1)]. This prevents one spouse from using the other as a conduit to pass a tax-free gift to another beneficiary. Interests that terminate entirely without passing to a third person are generally deductible (tenancies by the entirety, joint tenancies exclusively between spouses, and joint and survivor annuities). If the surviving spouse is given certain rights, such as the right to income for life, and an election is made, certain terminable interests also qualify for the marital deduction. Such interests are included in the surviving spouse's gross estate even though the disposition of the property is determined by the original donor/decedent. See *Qualified terminable interest property (QTIP) trust* on Page 15-13 for more information. See Section 2523(e) and (f) and Section 2056(b).

Tax Extenders Legislation—Updated for 2010 Tax Relief Act

Note: When the 2010 *1040 Quickfinder® Handbook* was published, Congress was considering legislation that would extend many expired tax provisions to 2010. The *Tax Extenders Legislation* table on Page 17-2 of the Handbook listed many expired provisions that, at the time of publication, might be extended. After the Handbook was published, the 2010 Tax Relief Act extended many of the provisions listed in the Tax Extenders Legislation table, which is reproduced below, along with a new column noting whether the provision was extended. For more details, see the *2010 Tax Relief Act Table* in the Updates section of *Quickfinder.com*.

Item	*Description of Expired Provision*	*QF Page*	*Extended to 2010?*
Individual Deductions			
Casualty Losses	Individuals' per-casualty floor for losses on personal-use property raised from $100 to $500.	5-15	No
Conservation Contributions	Increased percentage-of-AGI limits for contributions of real property for conservation purposes.	5-12	Yes
Educator's Expenses	Up to $250 above-the-line deduction for educator's expenses.	9-7	Yes
Real Property Taxes	Standard deduction increased by up to $500 ($1,000 if MFJ) of real property taxes paid.	4-19	No
Sales Tax	Election to deduct state and local sales taxes instead of state and local income taxes.	5-5	Yes
Tuition and Fees	Up to $4,000 above-the line deduction for qualified higher education tuition and fees.	13-4	Yes
Individual Retirement Accounts			
Charitable Rollover	Qualified charitable distributions (QCDs) from IRAs for individuals age 70½ or older. **Note:** The new law also allows individuals to treat a QCD made in January 2011 as made on 12/31/10.	14-13	Yes
Businesses and Sole Proprietors			
Environmental Remediation	Expensing for cost of Brownfields environmental remediation.	–	Yes
Farm Equipment	Five-year depreciation recovery period for new farming business machinery and equipment.	6-21, 10-2	No
15-Year Life for Certain Real Property	15-year (39-year for ADS) straight-line depreciation for qualified leasehold improvements, qualified restaurant property and qualified retail improvements.	10-13, 10-14	Yes
Charitable Contributions	Charitable deduction enhancement for businesses for contributions of food inventory, book inventories to public schools (C corporations only) or computer equipment for educational purposes (C corporations only).	C-14[1]	Yes
Domestic Producer's Deduction	Domestic producer's (Section 199) deduction allowable for income attributable to production activities in Puerto Rico.	6-22	Yes
Percentage Depletion	Suspension of the 100% of net income limit on percentage depletion for marginal oil and gas well production.	12-26	Yes
S Corporation Stock	S shareholders reduce their stock basis by their allocable share of the property's adjusted basis when S corporations make charitable contributions of property.	–	Yes
Alternative Minimum Tax			
Increased Exemption	Increase to the AMT exemption amounts, which for 2010 are now $72,450 (MFJ or QW), $47,450 (Single or HOH) and $36,225 (MFS).	12-15	Yes
Use of Credits to Offset	Allow the following credits to offset AMT: child and dependent care, elderly or disabled, mortgage interest, lifetime learning, personal energy property and DC first-time homebuyers.	12-1, 12-3, 12-8, 12-12	Yes
Tax Credits			
Alternative Motor Vehicles	Tax credit for hybrid vehicles *other than* passenger automobiles and light trucks.	–	No
Differential Wage Payment	Employer wage credit for activated military reservists.	O-7[1]	Yes
New Energy Efficient Homes Credit	$2,000 tax credit per qualifying home for builders of energy efficient homes.	O-11[1]	Yes
New Markets Credit	Credit for investment in community development entities.	O-7[1]	Yes
Research Credit	Research and experimentation expenses credit.	O-7[1]	Yes
Federally Declared Disasters			
Casualty Losses	Waiver of 10%-of-AGI threshold for net disaster losses.	5-15	No
Special Depreciation Allowance	Property that replaces or rehabilitates property destroyed in a federally declared disaster qualifies for the 50% special depreciation allowance.	5-15	No
NOL Carryback	An NOL attributable to a qualified disaster loss can be carried back five years.	5-15, 6-14	No
Qualified Disaster Expenses	Certain business expenses related to a federally declared disaster can be expensed instead of capitalized.	5-15	No

[1] Reference is to the 2010 *Small Business Quickfinder® Handbook*.