

# Tax Tips

Keeping You Informed • Summer 2011

FROM YOUR FRIENDS AT

**MACO ASSOCIATES**

196 W. Ashland St. • Doylestown, PA 18901  
610.489.7215 • info@macoassociates.com  
www.macoassociates.com

## Mortgage Debt Forgiven?

### *You may qualify for tax relief*

More and more home owners have experienced mortgage debt forgiveness. If your mortgage debt is partly or entirely forgiven after 2006 and before 2013, you may be eligible for special tax relief. Normally, debt forgiveness results in taxable income; however, under the *Mortgage Forgiveness Debt Relief Act of 2007*, you may be able to exclude up to \$2 million (\$1 million for married filing separate) of qualified principal residence indebtedness.

Debt reduced through mortgage restructuring and mortgage debt forgiven in a foreclosure may be excluded. To qualify, the debt must have resulted from buying, building or substantially improving your principal residence. It also must be secured by that residence. Refinanced debt proceeds used for the purpose of substantially improving your principal residence also qualifies for the exclusion.

Proceeds of refinanced debt used for other purposes, such as paying off credit cards, do not qualify for the exclusion. Debt forgiven on second homes, rental property, business property, credit cards or car loans also do not qualify for this tax relief provision. However, these situations may qualify under bankruptcy, insolvency or as qualified business use real property.

In the year your debt is reduced or eliminated, your bank should send you Form 1099-C, *Cancellation of Debt*. Bring it to your tax appointment so the required forms can be filed.



## IRS Lists Japan as a Qualified Disaster Area

*Victims offered a bit of relief*

The earthquake and tsunami that occurred in Japan in March were catastrophic. The IRS determined that these events are a qualified disaster for purposes of the federal tax law. This means that qualified disaster relief payments made by an employer-sponsored private foundation to employees and their family members in areas affected by the earthquake and tsunami in Japan can be excluded from income on their tax returns. Also, this guidance allows employer-sponsored private foundations to assist employee victims without affecting their tax-exempt status. These payments generally include amounts to cover necessary personal, family, living or funeral expenses that were not covered by insurance. They also include expenses to repair or rehabilitate personal residences or repair/replace the contents to the extent that they were not covered by insurance.

## Name Changes

*Getting married or divorced?*

If you changed your name as a result of a recent marriage or divorce, you'll want to take the necessary steps to ensure the name on your tax return matches the name registered with the Social Security Administration (SSA). A discrepancy between the name shown on your tax return and the SSA records can cause problems in the processing of your return and may even delay your refund.

Informing the SSA of a name change is easy. Obtain Form SS-5, *Application for a Social Security Card*, at your local SSA office

and provide a recently issued document as proof of your legal name change. This document may be your marriage license or your divorce decree. Your new card will have the same social security number as your previous card, but will show your new name.

## Credit for Child and Dependent Care Expenses

*Are your child care expenses deductible?*

There is a credit for child and dependent care expenses offered on your individual tax return. The credit can be up to 35 percent of your qualifying expenses, depending upon your adjusted gross income.

To be eligible, the person receiving the care must be a qualifying person—either your dependent child under the age of 13 or certain other individuals who are physically or mentally incapable of self-care. If you are divorced or separated, only the custodial parent can claim this credit.

The care must have been provided while you (and your spouse) are either working or looking for work. If you are married, you must file a joint return in order to qualify for the credit. In order to claim the credit, you (and your spouse) must have earned income from wages, salaries, tips or net earnings from self-employment. One spouse can be exempt from having earned income if he or she was a full-time student or was physically or mentally unable to care for himself/herself.

Additionally, expenses must be paid to a qualified caregiver. Spouses, dependents and children under the age of 19 are not

qualified caregivers. At the end of the year, most caregivers will provide a statement with their federal employer ID number (EIN) or social security number (SSN), full name, address and amount paid. All of this information is necessary for your tax return. If you do not receive a statement at the end of the year with this information, you should request it prior to your tax appointment.

If your employer provides a dependent care benefit, the amount of dependent care expense claimed must be reduced by the benefit you receive. If you pay someone to come to your home and provide care, you may be considered a household employer. Please contact your tax professional for guidance.





## Receiving Tip Income

*Do you know the tax implications?*

Many taxpayers are getting summer jobs at golf courses, restaurants or festivals where they will be receiving tips. These employees need to be aware of the tax consequences associated with this type of payment.

Tips are income. All cash tips you receive directly from customers, tips added to credit cards and your share of any tips you receive under a tip-splitting arrangement with fellow employees are considered income.

Tips are taxable. Tips are subject to federal income, social security and Medicare taxes. The value of noncash tips, such as tickets, passes or other items of value, are also income and subject to tax.

Tip off your employer. If you receive \$20 or more in tips in any one month, you should report all of your tips to your employer. Your employer is required to withhold federal income, social security and Medicare taxes on the reported tips.

## Does Your Child Have Investments?

*Your child's investments could be taxed at your rate*

Some parents choose to place investments in their children's names. These investments can be a good tax-savings strategy depending on your income bracket. Investment income includes interest, dividends, capital gain distributions and gains from the sale of capital assets (stock). If you plan carefully, each child's first \$950 of investment income will result in no tax. The next \$950 of investment income will be taxed at the lowest rate of 10 percent.

It's important to know that if the investment income exceeds \$1,900, and the child is under the age of 19 (age 24 if a full-time student), he or she could be subject to "kiddie tax" rules. If your child will be subject to this tax, contact your tax professional for further advice.

## Quik Tips

1

If you moved recently, notify the IRS of your change of address by filing Form 8822.

2

The HSA annual deductible contribution limit for 2011 is \$3,050 for individuals and \$6,150 for families.

3

The American Opportunity Education Credit was extended for 2011; the maximum benefit is \$2,500.

4

For the 2011 payroll tax holiday, social security tax withholding will be 4.2 percent, down from 6.2 percent. This will save the average taxpayer \$1,000.

5

Don't forget to use up the funds in your flexible-spending account (FSA) before the end of the year. You are not allowed to roll over this money, so use it or lose it.

6

Maximum 401(k) contributions remain unchanged at \$16,500 for 2011.

7

For your 2011 return, the maximum credit you can claim for installing energy-saving windows, doors, roofs or other eligible improvements or property is \$500 (\$200 for windows). Be aware the amount you claimed for the credit in 2006, 2007, 2009 or 2010 will reduce the amount you can claim in 2011.

## Divorce Payments

*Are these payments considered alimony?*

Determining the tax consequences of a divorce or marital separation can be vital for the financial protection and well being of you and your family. Figuring out whether a payment is alimony or child support can be confusing.

Generally, alimony is the amount paid to a spouse for his or her living expenses, education, health or life insurance, property taxes or mortgage payment. Alimony is not for providing child support. The person receiving alimony must pay taxes on the amount in the year it is received, and the paying spouse may deduct the amount in the year it is paid, provided the alimony meets all of the following conditions:

- The payment is made in a cash form, which includes checks, bank deposits, etc. Payments in the form of such things as bonds, stocks, money market shares or actual objects are not considered alimony for tax purposes.
- The payment is made as the result of a legal separation agreement or divorce decree.
- The spouses do not live in the same household at the time the payment is made and do not file a joint return.
- The divorce decree does not designate the payment as non-taxable.

- There can be no liability for payments after the death of the receiving spouse.

Child support, unlike alimony, is not taxable to the spouse who receives the payment, nor is it a tax deduction for the spouse who makes the payment. A divorce decree may specifically call the payment “alimony,” but the payment may have the characteristics of child support.

One characteristic of a child support payment might be the designation in the divorce document that the payment be terminated if the child’s situation changes.

Tax challenges during and following a divorce are common, but they can be minimized with some knowledge about tax laws and IRS procedures.

