

# Summary of Federal Tax Law Changes for 2010-2011

Updated for Tax Year: 2010

Learn how federal tax law changes could impact your tax return in 2010 and beyond.

Many of the tax breaks in recent tax-relief bills were designed to be phased in over a number of years, or are indexed to inflation. To help you determine how these tax laws affect your long-term planning, this article explains the changes scheduled to come into effect through 2011.

Pick a year from the list below to learn what tax changes affect that year's returns. We include changes for 2010 because they affect the tax returns you'll be working on in the spring of 2011. Congress made many significant tax changes in late 2010, including passage of the Tax Relief Act, that will have a major impact over the next several years.



## Started or Continuing in 2010

### Tax Credit of up to \$8,000 for First-Time Homebuyers and \$6,500 for Existing Homeowners

The Congress and the Obama Administration extended and expanded the wildly popular 2008 first-time homebuyer tax credit. In addition, the income limits were increased, making even more people eligible.

Existing homebuyers are eligible to receive a tax credit of 10% of the purchase price up to \$6,500 if they bought and closed on a replacement home by September 30, 2010. In order to be eligible for the credit, homeowners must have lived in the same principal residence for any five-consecutive-year period during the past eight years. They are not required to sell or dispose of their current home, but the new home must become their principal residence.

If you purchased and closed on a primary residence before September 30, 2010, and are a "first-time" homebuyer, you can qualify for a tax credit of 10% of the purchase price up to \$8,000. To be eligible, you must not have owned a residence in the United States in the previous three years.

To qualify for either credit, you must have signed a binding contract to buy the house by April 30, 2010, and closed on it by September 30.

Members of the armed forces who were on official extended duty outside of the United States for at least 90 days between Jan .1, 2009, and May 1, 2010, may qualify for a one-year extension.

The credit is refundable to the extent it exceeds your regular tax liability, which means that if it more than offsets your tax liability, you'll get a refund check. But it does not offset the Alternative Minimum Tax.

In addition, income limits were expanded from earlier versions of the credit. Homebuyers who file as single or head-of-household taxpayers can claim the full credit if their modified adjusted gross income (MAGI) is less than \$125,000. For married couples filing a joint return, the combined income limit is \$225,000.

Single or head-of-household taxpayers who earn between \$125,000 and \$145,000, and married couples who earn between \$225,000 and \$245,000 are eligible to receive a partial credit. The credit is not available for single taxpayers whose MAGI is greater than \$145,000 and married couples with a MAGI over \$245,000. Also, homes costing more than \$800,000 are not eligible for the credit.

### **Payroll Tax Credit**

For 2009 and 2010, Congress gave workers a credit of 6.2 percent of their earned income, capped at \$400 for single filers and \$800 for joint filers. For single filers, the credit starts phasing out at \$75,000 of Adjusted Gross Income and dries up at \$95,000. The phaseout zone for couples is \$150,000-\$190,000. Employees will get the credit in advance via lower income tax withholding in each paycheck, not as a rebate check.

Self-employed taxpayers can reduce their quarterly estimated payments to get an advance benefit from the credit. The exact amount of the payroll tax credit for the year will be calculated on the filers' tax returns.

### **Indexed Tax Brackets**

The 10 percent, 15 percent, 25 percent, 28 percent, 33 percent and 35 percent tax brackets all kick in at income levels that are more than 4 percent higher than they were in 2009.

### **Personal Exemptions**

For 2010, each personal exemption you can claim is worth \$3,650, the same as in 2009.

### **Standard Deductions**

For 2010, the standard deduction for married taxpayers filing a joint return is \$11,400, the same as in 2009.

For single filers, the amount is \$5,700 in 2010, up by \$250 over 2009. Heads of household can claim \$8,400 in 2010, up \$50 from 2009.

Non-itemizers can also add any casualty losses that occurred in presidentially-declared disaster areas.

### **Income Phaseouts for Itemized Deductions and Personal Exemptions for High-Income Taxpayers**

The amount of itemized deductions and personal exemptions you can take are normally phased out as your income rises. In 2010, however, those income limits have been repealed, and the recent tax relief act extends the repeal for two more years, through 2012.

### **Section 179 Expense Deduction**

The maximum amount of equipment placed in service in 2010 and 2011 that businesses can expense was increased to \$500,000. And the annual investment limit was raised to \$2,000,000. Thus, you won't begin to lose the benefit of expensing until you place more than \$2,000,000 of assets in service in 2010 and 2011. The allowance drops to \$125,000 for tax years beginning in 2012.

### **Tax-Free Parking for Employees**

Companies can pay for \$230 a month of parking tax-free for employees. The cap on tax-free transit passes is now \$230 a month as well, the same as for parking.

### **Tax Credit for College Tuition**

For 2010 through 2012, the Hope credit is replaced by a new credit. Now called the American Opportunity Tax Credit, it provides a credit of up to \$2,500 per student per year for four years of college. It now also covers the

cost of books, and begins to phase out at \$80,000 of Adjusted Gross Income for single filers and \$160,000 for joint filers. If the credit is more than your income tax liability, 40 percent of it is refundable. Also, the full credit is allowed against the Alternative Minimum Tax.

### **Child Tax Credit**

If the credit exceeds the filer's tax liability, all or part of the credit will be refunded if the filer earns more than \$3,000 in 2010, down from \$12,550 in earnings previously.

### **Earned Income Tax Credit (EITC)**

For families with three or more children, the maximum Earned Income Tax Credit for 2010 rises by \$628.50. And the phaseout of the credit for joint filers starts at higher income levels in 2010, allowing more of them to claim the credit.

### **Nontaxable Combat Pay Allowed for Earned Income Tax Credit (EITC)**

The election to include nontaxable combat pay in the calculation of earned income for the Earned Income Tax Credit applies for 2010.

### **Direct Donations of IRAs to Charity**

IRA owners age 70½ and older can donate up to \$100,000 of their IRAs to charity through 2012 without having to report the withdrawal as income and deduct the donation as a charitable contribution. Deductions will not be limited by the Adjusted Gross Income cap on charitable contributions or the itemized deduction phaseout. Keeping IRA distributions out of adjustable gross income in the first place can also have other benefits. Amounts donated in this way count as all of part of the IRA owner's required minimum distribution.

### **Higher Income Limits for Deductible IRAs and for Roth IRAs**

If you are covered by a retirement plan at work, you can take a full IRA deduction in 2010 if your modified Adjusted Gross Income is less than \$109,000 (married filing jointly) or \$66,000 (single or head of household). A partial deduction is allowed until your Adjusted Gross Income reaches \$109,000 if you are married filing jointly, or \$75,000 if you are single or a head of household. Also, the opportunity to contribute to a Roth IRA is now phased out as your modified Adjusted Gross Income rises between \$166,000 and \$176,000 if you are married filing jointly, or \$105,000 to \$120,000 if you are single or a head of household.

### **Roth IRA Conversions**

Starting in 2010, individuals with any amount of modified Adjusted Gross Income are free to convert a traditional IRA to a Roth IRA. Conversions are fully taxable at your regular tax rate. For conversions in 2010, taxpayers can spread the tax due over two years. Half of the conversion will be taxed in 2011, and the remainder will be taxed in 2012. Removing the limit on conversions effectively eliminates the income limit on contributions to Roth IRAs. A taxpayer with income too high to use a Roth will be able to contribute to a traditional IRA (which does not have income limits for contributions) and immediately convert to a Roth.

### **Contribution Limit for 401(k) Plans**

The maximum employee contribution is \$16,500 in 2010 for 401(k) and similar workplace retirement plans, including 403(b)s and the federal Thrift Savings Plan. Workers age 50 and older in 2010 can put in an additional \$5,500, making their maximum \$22,000.

### **Tax Rate on Capital Gains**

The tax rate on capital gains from the sale of assets held longer than one year remains at zero percent for people in the 10 percent or 15 percent tax brackets. The 15 percent maximum tax rate on long-term capital gains for taxpayers in higher brackets also remains the same.

### **Tax Rate on Dividends**

Similarly, the special 5 percent maximum rate on dividends of taxpayers in the 10 percent and 15 percent tax brackets remains at zero percent.

### **Estate Tax Exemption**

For 2010, there is no federal estate tax. However the executors of estates where the taxpayer died in 2010 can elect to apply the 2011 exemption of \$5,000,000, with a maximum estate tax of 35%. Different rules for the step up in cost basis apply in these two years, meaning some estates may find the 2011 rules more beneficial. The estate tax was reinstated in the 2010 Tax Relief Act.

### **Higher Annual Gift Tax Exemption**

For 2010, you can give up any individual up to \$13,000 without owing any gift tax.

### **Credit for Residential Energy Efficient Property**

The credit for 30 percent of the cost of installing solar water heating equipment, solar electric equipment, geothermal heat pumps or small wind turbines in your primary residence or a second home is unlimited in 2010. But the credit for fuel cell property cannot exceed \$500 per half-kilowatt capacity.

### **Credit for Energy-Saving Home Improvements**

The tax credit for the cost of energy-saving home improvements is 30 percent for 2010, up to a combined maximum of \$1,500 in both 2009 and 2010. It applies to qualified insulation, windows, outside doors, biomass fuel stoves and high-efficiency furnaces, water heaters and central air conditioners.

### **Converting a Second Home to a Primary Home**

If you convert a second home into a principal residence after 2008, you may not be able to exclude all of your gain. A portion of the gain on a subsequent sale of the home will be ineligible for the home-sale exclusion of up to \$500,000, even if the seller meets the two-year ownership-and-use tests. The portion of the profit that's subject to tax is based on the ratio of the time after 2008 when the house was a second home or a rental unit, to the total time you owned it. So if you have owned a vacation home for 18 years and make it your main residence in 2011 for two years before selling it, only 10 percent of the gain (two years of nonqualified second home use divided by 20 years of total ownership) is taxed. The rest qualifies for the home-sale exclusion of up to \$500,000.

### **Refundable Child Tax Credit**

The income threshold needed to qualify to claim the child tax credit if it exceeds your regular income tax bill is \$3,000.

### **College Savings Plans**

529 College Savings Plans can now be tapped tax-free to pay for a computer or Internet access.

### **Estimated Tax Relief for Owners of Small Businesses**

If an individual's Adjusted Gross Income for 2009 was less than \$500,000 and more than half of the gross income was from a business with fewer than 500 workers, the estimated income taxes for 2010 estimated tax payments can be based on the lesser of 90 percent of tax liability for 2009 or 2010. The usual estimated tax benchmarks of 100 percent or 110 percent of tax liability do not apply.

### **Domestic Production Activities Deduction**

In 2010, this deduction increases to nine percent of qualifying business net income. This deduction applies to businesses engaged in construction, engineering or architectural services, film production, or the lease, rental or sale of equipment you manufactured. However, the rate remains six percent for oil and gas companies.

### **Educators' Deduction**

You can deduct up to \$250 (\$500 if married filing joint and both spouses are educators, but not more than \$250 each) of any unreimbursed expenses you paid or incurred for books, supplies, computer equipment (including related software and services), other equipment, and supplementary materials that you use in the classroom. You must have worked at least 900 hours a school year in a school that provides elementary or secondary education.

This deduction has been extended through the end of 2011.

### **Tuition and Fees Deduction**

You can deduct up to \$4,000 of college tuition and fees through 2011.

### **Income Earned Abroad**

The maximum foreign earned income exclusion is increased to \$91,500. This is a \$100 increase from 2009.

### **Limits on Deducting Farm Losses**

Beginning in 2010, the amount of farm losses you can enter to offset nonfarm income is capped at the greater of \$300,000 or your net farm income over the past five years. But this limit will apply only if you get federal farm payments or Commodity Credit Corporation (CCC) loans. You can take suspended losses in later years. The caps will also apply to partners and S corporation owners.

### **Exemptions for the Alternative Minimum Tax**

For 2010, the exemption levels were increased to \$72,450 for married couples filing jointly, \$47,450 for singles and heads of household, and \$36,225 for married couples filing separately.

### **Partial Exclusion for Unemployment Benefits**

For 2010, the first \$2,400 of unemployment benefits you receive is no longer tax-free.

### **Sales Tax Deduction for New Vehicles**

Beginning in 2010, buyers of new vehicles no longer get a tax benefit for sales tax paid on new vehicles, unless they itemize and elect to deduct sales taxes instead of state income taxes.

## **Starting in 2011**

### **Lower Tax Rates Extended**

The 2010 Tax Relief Act extends through the end of 2012 the tax rates in effect in 2010. They had been scheduled to increase to the higher tax rates that were in effect prior to 2001.

### **Estate Tax**

For individuals dying after 2010, the federal estate tax continues with a \$5 million exemption and a 35 percent maximum rate. The current federal estate tax rules are scheduled to end after 2012.

### **Lower Capital Gains and Dividend Tax Rates Extended Through 2012**

The tax rate reductions for long-term capital gains remain in effect for 2011 and 2012.

### **Child Tax Credit**

The credit of \$1,000 per eligible child continues through 2012. The credit was extended by two years by the 2010 Tax Relief Act.

### **Payroll Tax Credit**

Starting in 2011, the partial credit for payroll taxes paid by employers is no longer available.

### **Section 179 Expense Deduction**

The \$500,000 maximum amount of equipment placed in service that businesses can expense and the annual investment limit of \$2,000,000 remain in effect for 2011.

### **Tax Credit for College Tuition**

The American Opportunity Tax Credit remains in effect through 2012.

### **Earned Income Tax Credit (EITC)**

Temporary increases in the Earned Income Tax Credit for filers with three or more children and the higher income levels for the phaseout of the credit have been extended through the end of 2012.

### **Mortgage Insurance Premiums**

The special itemized deduction for mortgage insurance premiums paid on mortgages taken out after 2006 expires on Dec. 31, 2010.

### **Credit for Energy-Saving Home Improvements**

The 30 percent tax credit of the cost of energy-saving home improvements was extended by the Tax Relief Act of 2010 through 2011.

## **Starting in 2013**

### **Tax Relief for Taxpayers Who Lose Their Homes Due to Foreclosure Expires**

Beginning in 2013, debt forgiven in connection with the foreclosure of a principal residence will once again be considered taxable income (unless you are in bankruptcy or insolvent).

## **Starting in 2017**

### **Credit for Residential Energy-Efficient Property**

The credit for 30 percent of the cost of installing solar water heating equipment, photovoltaic or fuel cell equipment, geothermal heat pumps or wind turbines in your primary residence or a second home does not apply after 2016.

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