

Dear Client,

The Internal Revenue Service Tax Code is constantly changing. We are providing you with this summary designed to help you keep track of what is new for 2011 and beyond. The summary includes four groups of tax changes, A) New Items for 2011 Affecting Individuals, B) New Items for 2011 Affecting Businesses, C) Tax Changes for 2012 D) Tax Changes for 2013 and thereafter and E) Payroll Tax Changes for 2012.

A) New for 2011 Affecting Individuals

- A taxpayer that switched from a traditional IRA to a Roth IRA in 2010 and elected to defer paying tax on it, will begin paying tax. It will be fully taxable at your regular tax rate. For conversions in 2010, taxpayers were able to spread the tax due over two years. Half the tax will be due in 2011, and the remaining half will be payable in 2012.
- For 2011 only, the employee and self-employed portion of the FICA-OASDI Social Security taxes are decreased by 2%, so that the tax rate is 4.2% for employees and 10.4% for self-employed.
- The self-employment tax rate is reduced from 15.3% to 13.3%. (10.4% for social security and 2.9% for medicare)
- The costs for over-the-counter drugs not prescribed by a doctor are excluded from being reimbursed through a health reimbursement account (HRA) or health flexible savings accounts (FSAs) and from being reimbursed on a tax-free basis through a health savings account (HSA) or Archer Medical Savings Account (MSA).
- The tax on distributions from a health savings account or an Archer MSA that are not used for qualified medical expenses is increased to 20% (from 10% for HSAs and from 15% for Archer MSAs) of the disbursed amount.
- The personal exemption amount is \$3,700 in 2011, up from \$3,650 in 2010.
- The nonbusiness energy property credit is available for property placed in service in 2011, but with new limitations. The credit now has a lifetime limit of \$500, of which only \$200 may be used for windows. Credits claimed on 2009 and 2010 returns count against the \$500 limit.
- For payments made after December 31, 2010, for information reporting purposes, a person receiving rental income from real estate is treated as engaged in the trade or business of renting property. As a result, recipients of rental income from real estate generally are subject to the same information reporting requirements as taxpayers engaged in a trade or business. In particular, rental income recipients making payments of \$600 or more during the tax year to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income must provide an information return (typically Form 1099-MISC) to the IRS and to the service provider.
- If you claimed the First-Time Homebuyer credit for a home purchased in 2008, you should have started repayment on your 2010 return (that was due April 18, 2011). Repayment will continue on your 2011 return and beyond until the credit is repaid.

- The standard mileage rates for 2011 for the use of a vehicle is:
 - 51 cents per mile for the first half and 55.5 cents per mile for the second half for business miles driven
 - 19 cents per mile driven for the first half and 23.5 cents per mile for the second half for medical or moving purposes
 - 14 cents per mile driven in service of charitable organizations

We will update you on the 2012 mileage rates when they are issued early next year.

B) New For 2011 Affecting Business

- A Business Tax Credit for Retention has been passed for any newly hired qualified employee that is retained for 52 consecutive weeks from the date of hire. This credit is taken on the employer's 2011 tax return. The employee must fit the criteria below of being a qualified employee, and be retained for 52 consecutive weeks, without a significant decrease in pay level. The credit is the lesser of \$1,000 or 6.2% of the employee's wages during the 52 consecutive week period. At year end please provide details of employees meeting the criteria in order to obtain available tax relief.

Qualified Employee (must meet **each** of the qualifications below)

- Has not been employed for more than forty hours in the continuous sixty days prior to their first day of work with your company
 - Is not related to any members of ownership of your company
 - Begins employment between February 3, 2010 and January 1, 2011
 - Can be an employee that was previously laid off and then rehired by the company
 - Signs Form W-11, an affidavit verifying their prior unemployment status
 - Does not replace a current employee unless they left voluntarily or for just cause
- Small employers are eligible for a tax credit (i.e., a dollar-for-dollar reduction in tax) for nonelective contributions to purchase health insurance for their employees. The credit can offset an employer's regular tax or its alternative minimum tax (AMT) liability. At year end we will need information from you regarding health insurance to obtain the credit.

Small business employers eligible for the credit. To qualify, a business must offer health insurance to its employees as part of their compensation and contribute at least half the total premium cost. The business must have no more than 25 full-time equivalent employees ("FTEs"), and the employees must have annual full-time equivalent wages that average no more than \$50,000. However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of not more than \$25,000.

Years the credit is available. The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a state exchange and is only available for two years. The maximum two-year coverage period does not take into account any tax years beginning in years before 2014. Thus, an eligible small employer could potentially qualify for this credit for six tax years, four years under the first phase and two years under the second phase.

Calculating the amount of the credit. For tax years beginning in 2010, 2011, 2012, or 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. The credit phases out as firm-size and average wages increase.

Special rules. The employer is entitled to an ordinary and necessary business expense deduction equal to the amount of the employer contribution minus the dollar amount of the credit. For example, if an eligible small employer pays 100% of the cost of its employees' health insurance coverage and the amount of the tax credit is 50% of that cost (i.e., in tax years beginning after 2013), the employer can claim a deduction for the other 50% of the premium cost. Self-employed individuals, including partners and sole proprietors, two percent shareholders of an S corporation, and five percent owners of the employer are not treated as employees for purposes of this credit. There is also a special rule to prevent sole proprietorships from receiving the credit for the owner and their family members. Thus, no credit is available for any contribution to the purchase of health insurance for these individuals and the individual is not taken into account in determining the number of full-time equivalent employees or average full-time equivalent wages.

- Most small businesses exempted from penalties for not offering coverage to their employees. Although the new law imposes penalties on certain businesses for not providing coverage to their employees (so-called "pay or play"), most small businesses won't have to worry about this provision because employers with fewer than 50 employees aren't subject to the "pay or play" penalty. For businesses with at least 50 employees, the possible penalties vary depending on whether or not the employer offers health insurance to its employees. If it does not offer coverage and it has at least one full-time employee who receives a premium tax credit, the business will be assessed a fee of \$2,000 per full-time employee, excluding the first 30 employees from the assessment. So, for example, an employer with 51 employees who doesn't offer health insurance to his employees will be subject to a penalty of \$42,000 (\$2,000 multiplied by 21). Employers with at least 50 employees that offer coverage but have at least one full-time employee receiving a premium tax credit will pay \$3,000 for each employee receiving a premium credit (capped at the amount of the penalty that the employer would have been assessed for a failure to provide coverage, or \$2,000 multiplied by the number of its full-time employees in excess of 30). These provisions take effect Jan. 1, 2014.
- There has been a one year extension to enhanced expensing rules (Section 179), which allow qualifying businesses the option to currently deduct the cost of business machinery and equipment, instead of recovering it via depreciation over a number of years. For tax years beginning in 2011, the maximum amount that a business may expense is \$500,000, and the expensing election begins to phase out when a business buys more than \$2,000,000 of expensing-eligible assets.

C) Tax Changes for 2012

- The social security wage limit for 2012 is \$110,100, an increase from the 2011 limit of \$106,800.
- The employee and self-employed portion of the FICA-OASDI Social Security taxes return to their previous rates of 6.2% for employees and 12.4% for self-employed. Pending any last minute changes from Congress, which we will keep you informed of.
- An additional requirement of the 2010 Health Care act, beginning in 2012, requires all businesses to file a 1099 for all payments to a single payee totaling \$600 or more in a calendar year, including corporations. Previously corporations were excluded from this requirement. This may require increased record keeping and changes to the current setup of software systems, as well as an increase in the information needed from a company's payee. Please contact us if you require assistance preparing for this change in reporting requirements.

D) Tax Changes for 2013 and thereafter

These changes are pending any further action by Congress. We will keep you informed of any changes that may be brought about.

- As part of the 2010 Health Care Act, beginning in 2013, the employee portion of the Medicare Tax will increase from 1.45% of wages to 2.35% of wages and from 2.9% to 3.8% for self-employment income. This additional tax will apply to combined wages of the taxpayer and spouse in excess of \$250,000 for joint returns and wages in excess of \$200,000 for single returns. Employers will not be affected by this tax; however, they will be required to withhold the additional .9% of tax from their employees with wages in excess of \$200,000. If this situation applies to you, you may be required to make estimated tax payments to cover the additional .9% of tax. Please contact us to review your situation if you believe this may apply to you.
- Also part of the 2010 Health Care Act, beginning in 2013, there will be a Medicare contribution tax of 3.8% on net investment income of individuals, estates, and trusts. This is in addition to the tax mentioned above. The tax is generally levied on income from interest, dividends, annuities, royalties, rents, and capital gains.

The tax is 3.8% of the lesser of net investment income or the excess of modified adjusted gross income over the thresholds of \$250,000 for joint filers and \$200,000 for single filers. Taxpayers who have both high wages or self-employment income and high investment income may be hit with both taxes.

E) Payroll Tax Changes for 2012

Beginning January 1, 2012 with the implementation of Act 32, every Pennsylvania employer is required to deduct from payroll the greater of the employee's **RESIDENT TAX** (where the employee lives) or the employee's **NONRESIDENT TAX** (where the employee works).

Employees are required to complete the Certificate of Residency form provided by the *Pennsylvania Department of Community and Economic Development* (DCED). This certificate of Residency provides information to help identify the political subdivisions where an employee lives and works. The employee must use a physical address; no P.O. Box addresses will be accepted.

Information on the tax rates & Political Subdivision Codes (PSD) for each municipality are available on the DCED website at <http://munstatspa.dced.state.pa.us>.

Determining the amount to withhold:

- 1) Determine the municipality in which the person's place of employment is located.
- 2) Determine from the Certificate of Residency the municipality and school district in which the employee resides.
- 3) Determine the income tax rate & PSD code for the municipality for which the employee resides.
- 4) Determine the income tax levied on nonresidents & PSD code by the municipality in which the employee's place of employment is located, this is the nonresident tax rate.
- 5) Withhold the tax at the greater of the resident tax rate or the nonresident rate.
- 6) If an employee moves, the employer must require the employee to file a new Certificate of Residence, and the employer then must repeat steps 1 thru 5.

Where to file:

If your business is located in:

Allegheny Central
Allegheny North
Allegheny Southwest
Allegheny Southeast
Greene County
Washington County

Jordan Tax Service, Inc.
Keystone Collections Group
Jordan Tax Service, Inc.
Keystone Collections Group
Central Tax Bureau of PA
Keystone Collections Group

www.jordantax.com
www.keystonecollects.com
www.jordantax.com
www.keystonecollects.com
www.centaxgroup.com
www.keystonecollects.com

As mentioned above, many of the new tax changes will require you to provide us with information not previously needed to enable you to fully comply with the laws and to take advantage of all available deductions and credits. We will provide more detail of what will be needed at tax time.

For the 2011 tax filing season, we will once again be electronically filing your tax returns. We have enclosed an information sheet for you to complete if you have had any changes to your information for the year. Please include this sheet when submitting your 2011 tax information to us for preparation of your returns.

We are currently in the process of compiling an email newsletter to keep our clients up to date with the latest tax changes and updates. **Please send us an email at info@pkacpa.com if you would like to be included in our email list.** We will not be mailing future updates, please join our email listing to be continue to receive this information. You may also check our website at www.pkacpa.com for additional information as it becomes available to us.

Please remember that we have covered the high points of the complex rule changes for 2011 and anticipated changes for 2012. If you have any questions or need additional information please call our office and we'll set up an appointment to discuss in detail how the changes may affect you, your family, and your business.

Very truly yours,

Palermo/Kissinger & Associates, P.C.