

TAXOLUTIONS



►► *ideas on taxes*

HOW MUCH TAX SHOULD I HAVE WITHHELD?

Each time you start a new job, your employer will give you a Form W-4 to complete that determines the amount of Federal income tax that is withheld from each paycheck. While many people prefer to have too much tax taken out so they can look forward to a refund in the spring, overpaying your taxes means you are allowing the IRS to hold on to your money. Conversely, underpaying your taxes can result in a big tax bill in April, and possibly penalties from the IRS for underpayment. To avoid these problems, strive to match the amount withheld as closely as possible to your actual tax liability, adjusting your rates and allowances as your status changes.

Form W-4 asks you to specify whether you want your taxes withheld at the single or married rate, how many withholding allowances you wish to claim, and whether you want an additional amount withheld from each paycheck. Claiming more allowances lowers the amount of taxes withheld, while claiming fewer increases the amount taken at each pay period. Using the worksheets that accompany Form W-4 or the withholding calculator on the IRS website can help you determine how many allowances you are entitled to claim.

If you have income from two jobs, the IRS recommends that you complete

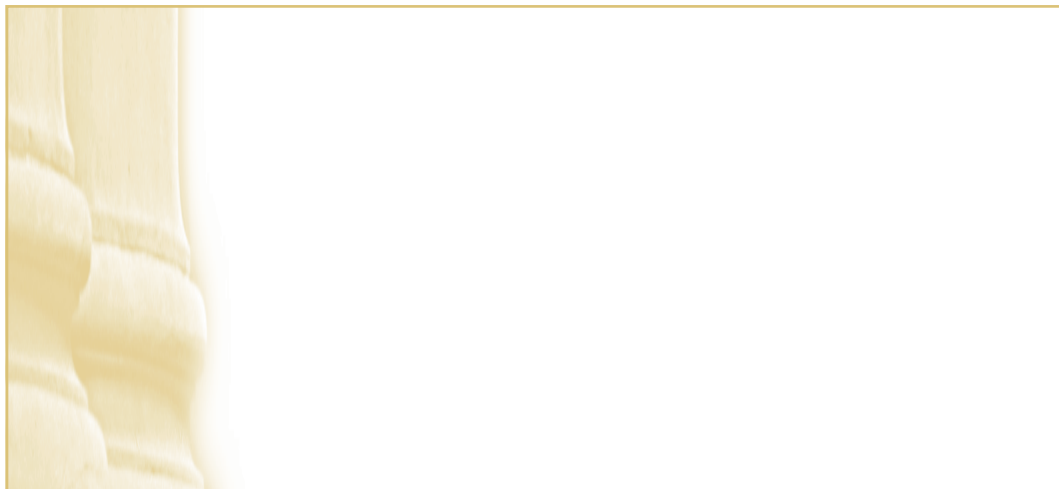
only one set of Form W-4 worksheets or online calculations, and that you then split your allowances between the Forms W-4 for each job. Alternatively, you can claim all your allowances with one employer and none with the other. However, you cannot claim the same allowances with more than one employer at the same time.

If you are married filing jointly and both you and your spouse are employed, calculate your withholding allowances using your combined family income, adjustments, deductions, exemptions, and credits—again, using just one set of worksheets or one set of calculations. While you and your spouse can divide your total allowances at your discretion, your family cannot claim an allowance twice. If, however, you and your spouse

expect to file separate returns, you should each calculate your allowances using separate worksheets based on your individual income, adjustments, and deductions.

When an event occurs in your life that affects your tax liability, adjust your Form W-4 to reflect the change. You can alter your withholding as frequently as you like by filling out a new form and submitting it to your employer. Events that may require you to recalculate the withholding amount include getting married or divorced, having a baby, and buying a house. You may also consider adjusting your withholding if your spouse starts or stops working; if you or your spouse takes on a second job; or if you have new income from non-wage

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REPORTING TIPS AS TAXABLE INCOME

Those employed in industries in which tipping is common may not know that the IRS views tips as potentially taxable income. Regardless of whether you are a restaurant server, a hairdresser, or a cab driver, all tips you receive, including non-cash gifts, are income and are subject to Federal income tax.

The IRS requires all workers who receive tips to include in their gross income all tips received directly from customers, charged tips paid to their employer, and their share of any tips received under a tip-splitting or tip-pooling arrangement. In addition, the value of non-cash tips, such as event tickets or movie passes, are also considered taxable income.

If you work in a profession in which tips comprise a portion of your income, you are required to keep a daily record of your tips. You can maintain your own tip diary or log, or use IRS Form 4070A, "Employee's Daily Record of Tips." The log should track all cash tips collected directly, as well as amounts received

from your employer for credit and debit card tips and through any tip-sharing arrangement between co-workers. If you are responsible for distributing pooled tips to co-workers, record the names of each employee and the amount received



in your daily log. If your employer has an electronic system for tracking tips, print out and keep a copy of your personal tip record. Whenever possible, keep copies of documents that show your tips,

such as restaurant bills and credit card receipts.

Besides keeping your own tip record, you are required by the IRS to report the total amount of tips you have received each month (provided the amount is more than \$20) by the 10th day of the following month, or the next business day if the 10th day falls on a weekend or holiday. You do not have to report to your employer non-cash tips or amounts paid out to co-workers through tip-pooling arrangements. However, you are required to report all cash tips, tips received from credit and debit cards, and any payments you received from tip-sharing arrangements. Your employer will withhold Social Security and Medicare (FICA) taxes, as well as Federal income taxes, from the amount you report. Failure to report tips to your employer as mandated may result in a penalty equal to 50% of the FICA taxes you owe on the unreported tips, in addition to the actual tax liability. If your regular pay is not sufficient to allow

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sources, such as an inheritance, unemployment compensation, retirement plan distributions, alimony, dividends, capital gains, interest, or gambling winnings.

Changing your withholding is particularly important if an event occurs that lowers the number of allowances you are entitled to claim, or if your income rises dramatically. In addition to the situations mentioned above, there are a number of other, less obvious events that could lead to a decrease in the number of allowances claimed. For example, if you have been claiming an allowance for a dependent who is a qualifying relative or child, but you

no longer expect to provide more than half of the dependent's support for the year, resubmit your W-4. Similarly, if you have been claiming allowances for your anticipated deductions, but you now find they will be lower than originally expected, a change in your withholding may be necessary.

Even if you do not realize until later in the year that you have been underpaying your taxes and may be liable for interest and penalties, it is not too late to adjust your W-4. Simply calculate the additional amount you expect to owe, and use the form to instruct your employer to withhold the extra amount over the remainder of your paychecks

for the year. To correct any future discrepancies, file a new Form W-4 in January that accurately reflects your changed tax situation.

In addition, consider adjusting your withholding if you have received a large refund and anticipate no changes in your tax liability for the coming year. Rather than overpaying the IRS over the course of the year, deposit the money into an interest-earning account, use the additional income to pay off credit card debt, or increase your retirement plan contributions.

For more information on withholding and to review your individual circumstances, consult your tax professional. ■

TAX RELIEF IN THE WAKE OF A DISASTER

When a disaster suddenly destroys your property, the prospect of cleaning up and rebuilding can seem overwhelming. One small consolation in such a situation can be the Federal tax relief available to those affected by unexpected and unusual events, such as a burglary or natural disasters like hurricanes, tornadoes, fires, and volcanic eruptions. In the wake of several major natural disasters in various parts of the country—including hurricanes and flooding in the Southeast, tornadoes and storms in the Midwest, and wildfires in California—recent legislation has increased the tax relief available to Americans who have suffered property damage or loss in the wake of a disaster.

To qualify as a casualty loss under IRS rules, the damage to or destruction of your property must be the result of a sudden, unexpected, or unusual event that is clearly identifiable, and the loss must have occurred swiftly, not over a period of time. In addition to natural disasters, casualty loss may be the result of certain car accidents, vandalism, or terrorist attacks. Similarly, the Federal government provides relief to victims of various forms of theft, including burglary, robbery, blackmail, and embezzlement. These so-called “casualty, theft, and disaster losses” do not, however, include the results of accidental breakage of property, fires set by the owner of the property, car accidents caused by willful negligence, or gradual deterioration of the property.

If the property is for your personal use, the amount of your casualty or theft loss is defined by the IRS as being the lesser of the adjusted basis of your property or the decrease in the fair market value as a result of the casualty, theft, or disaster. The adjusted basis of the property is generally the cost of the property, which may have decreased or increased since the time of purchase. The decline in the fair market value of the property may be determined through an appraisal or an estimate for the cost of repairing the property.

Generally, to claim a deduction for casualty or theft losses of personal-use property, you must itemize your deductions on your tax return. You are permitted to deduct the total casualty or theft losses that exceed 10% of your adjusted gross income (AGI), after subtracting an additional \$100 for each casualty and theft event, as well as any insurance or other reimbursements for the losses. Casualty losses are claimed on Form 4684, “Casualties and Thefts,” which is attached to Form 1040.



However, it is important to note that recent legislation changed some of the rules associated with personal-use property losses incurred in presidentially declared disaster areas in 2008 and 2009. In the past, various forms of additional tax relief have been provided to victims of specific disasters, such as Hurricane Katrina or the storms that hit the Midwest in 2008. However, Congress subsequently passed the National Disaster Relief Act of 2008, which clarifies the tax benefits available to people affected by a Federally declared disaster. It is intended to replace the strategy of providing targeted benefits to disaster victims.

For tax years 2008 and 2009, the 10% of AGI limitation for disaster losses is lifted, and taxpayers affected by Federally declared disasters are permitted to claim casualty losses even if they do not itemize their deductions. But the new rules also increase to \$500 the amount

by which all individuals must reduce their casualty and theft losses for personal-use property. This \$500 reduction applies to each casualty or theft event occurring in 2009 only, and it will return to \$100 in 2010.

While casualty and theft losses are usually only deductible for the year in which they occur, you may also deduct losses that occurred from an event in a presidentially declared disaster area for the year immediately preceding the year in which the casualty occurred. If your tax return for the preceding year has already been filed, you are permitted to claim the loss in an amended return. This can, in some cases, provide you with an immediate tax refund.

When calculating your deductible losses if your business or income-producing property is completely destroyed, the decrease in fair market value is not considered. Instead, your loss is considered to be the adjusted basis of the property, reduced by any salvage value and any insurance payments or other reimbursements for the loss. You are not, however, permitted to consider the loss of future profits or income due to the loss of the property. The new natural disaster relief legislation provides some additional temporary tax breaks for business owners, including an increase in the Section 179 expensing limits.

To claim a deduction for a casualty or theft loss, you must be able to demonstrate that a disaster or theft took place, and you must provide evidence supporting the amount of the deduction you are claiming. The IRS may ask for proof that the catastrophe occurred during the tax year and that the loss was a direct result of the disaster or theft. You may also be required to produce documentation proving that you are the owner of the property, as well as information about insurance payments or any other reimbursement for the loss that you may be expected to receive.

To learn more about tax relief in the wake of a disaster, consult your tax professional. ■

Inflation Has Little Effect on Taxes in 2010

Because inflation was minimal during the first three quarters of 2009, the IRS has announced that tax rate brackets and the dollar amounts associated with various tax benefits will remain unchanged or increase only slightly in 2010. The adjustments released for 2010 are the smallest since the IRS began indexing income tax benefits on an annual basis in the mid-1980s.

When announcing the inflation adjustments, IRS officials noted that, by law, the dollar amounts for a variety of tax provisions must be revised each year to keep pace with inflation. However, because recent inflation factors have been minimal, many of these benefits will remain unchanged or be adjusted marginally for 2010. The U.S. Bureau of Labor Statistics' August estimate of the Consumer Price Index (CPI), the statistic used by the IRS in calculating tax

inflation indexing, was 0.19% in 2009, down sharply from 4.26% in 2008.

In 2010, the value of each personal and dependency exemption remains unchanged at \$3,650. While the standard deduction for head of household filers increases slightly to \$8,400, up from \$8,350 in 2009, the standard deduction is unchanged at \$11,400 for married couples filing jointly and at \$5,700 for singles and married couples filing separately. Meanwhile, the annual gift tax exclusion remains unchanged at \$13,000, and the 2009 kiddie tax deduction of \$950 remains unchanged in 2010. The Social Security Wage Base, the upper threshold on which an employee's Social Security tax may be imposed, also remains unchanged for 2010 at \$106,800.

In addition, various tax bracket thresholds will be adjusted only minimally. For single filers, the bracket threshold for

the 15% rate rises from \$8,350 in 2009 to \$8,375 in 2010, while the threshold for the 28% rate increases from \$82,250 to \$82,400. Similarly, for married couples filing jointly, the tax bracket threshold for the 15% rate rises from \$16,700 to \$16,750, and it increases from \$137,050 to \$137,300 for the 28% rate.

For retirement plans, the 2010 annual benefit limits for both defined contribution plans (\$49,000) and defined benefit plans (\$195,000) are unchanged from the 2009 limits. The maximum amount an employee under age 50 will be permitted to contribute to a 401(k) or other defined contribution plan in 2010 will hold steady at the 2009 limit of \$16,500, while maximum catch-up contributions for workers over age 50 will remain unchanged at \$5,500.

For more information, consult your tax professional.

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your employer to withhold the total taxes owed, you have until the end of the calendar year to give your employer the additional amount needed to cover the liability.

When completing your Federal income tax return, you report your tips with your regular wages on line 1 of Form 1040EZ, or line 7 of Form 1040A or Form 1040. You must report all tips, adding the value of non-cash tips to the amounts reported to your employer. The total amount of wages and tips reported to your employer will be shown in box 1 of your Form W-2.

You may also work for an employer that reports allocated tips, which, if applicable, would appear as an amount in box 8 of your Form W-2. A restaurant owner may, for example, use allocation

if there is reason to suspect that some staff members are underreporting tips. Generally, tips are allocated by taking a percentage of the restaurant's overall food and drink sales—usually 8% or an approved lower rate—and subtracting from that total all the tips reported for a given period. Any remaining amount is then allocated to individual employees for tax purposes. However, you can avoid reporting these allocated tips as income by keeping a detailed daily record of your tips, or by demonstrating that the value of the tips you received was higher than the combined total of the amounts shown in your employer's record of your tips and the amount allocated to you by your employer.

To help service industry employers and employees better comply with

tip reporting requirements, the IRS invites businesses to participate in its Tip Rate Determination and Education Program. There are a number of ways for businesses to participate, including the Tip Reporting Alternative Commitment (TRAC) program. By signing up for TRAC, employers agree to educate their employees about their tip reporting obligations and to establish systems for creating and maintaining tip records that can be easily accessed by the IRS. Participation in TRAC limits a business's liability for unpaid FICA taxes if an "employer-only" audit shows that individual employees have not been reporting their tip income properly.

To learn more about reporting tips as taxable income, consult your tax professional. ■