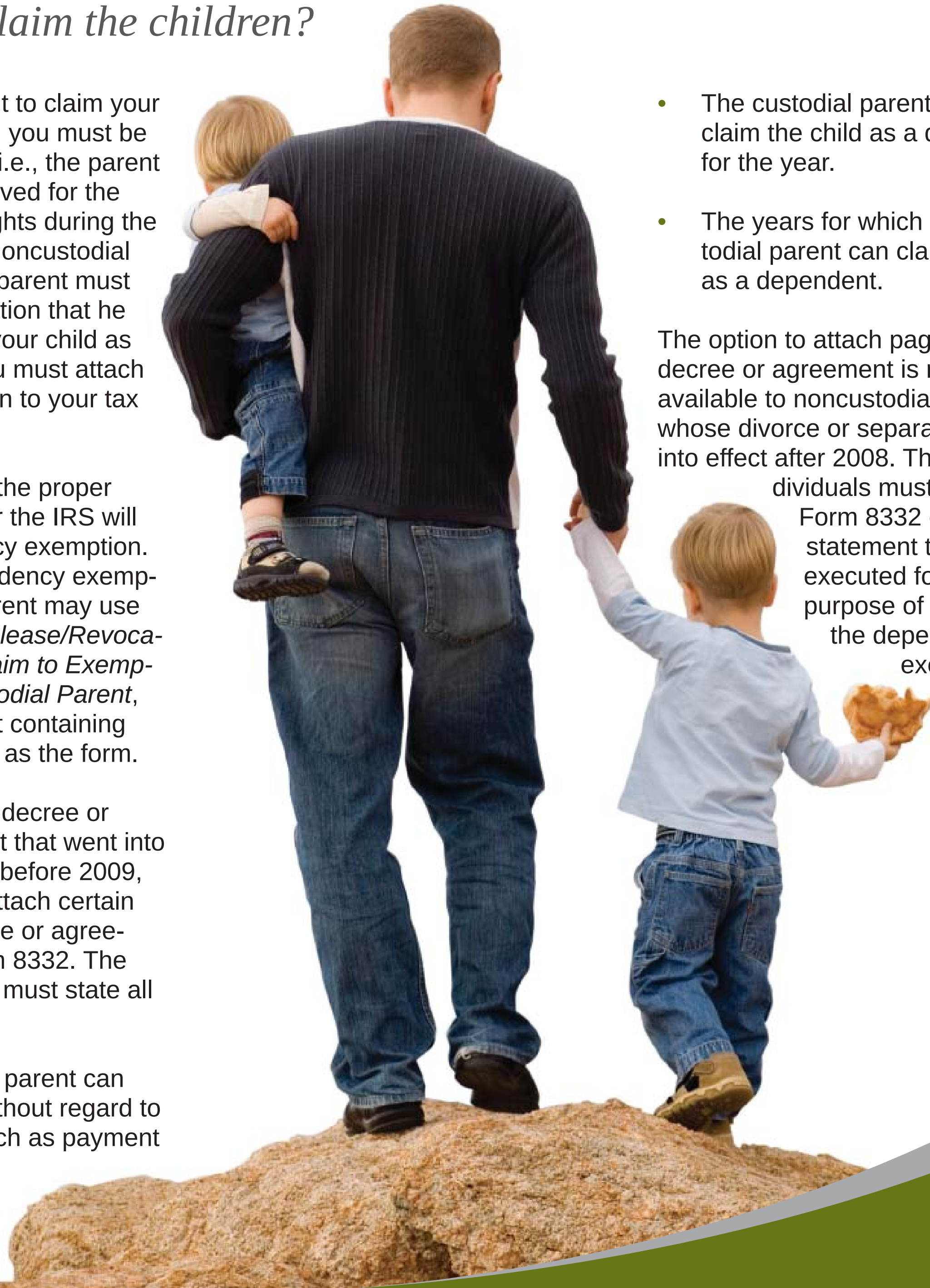
TaxTips

Keeping You Informed • Winter 2010

Dependents and Divorce

Who gets to claim the children?



In general, if you want to claim your child as a dependent, you must be the custodial parent (i.e., the parent with whom the child lived for the greater number of nights during the year). If you are the noncustodial parent, the custodial parent must sign a written declaration that he or she will not claim your child as a dependent, and you must attach this written declaration to your tax return.

Make sure you have the proper written declaration, or the IRS will deny your dependency exemption. To release the dependency exemption, the custodial parent may use either Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, or a similar statement containing the same information as the form.

If you have a divorce decree or separation agreement that went into effect after 1984 and before 2009, you may be able to attach certain pages from the decree or agreement in place of Form 8332. The decree or agreement must state all three of the following:

- The noncustodial parent can claim the child without regard to any condition, such as payment of support.
- The custodial parent will not claim the child as a dependent for the year.
- The years for which the noncustodial parent can claim the child as a dependent.

The option to attach pages from the decree or agreement is no longer available to noncustodial parents whose divorce or separation went into effect after 2008. These individuals must attach Form 8332 or a similar statement that was executed for the sole purpose of releasing the dependency exemption.

First-Time Homebuyer Credit

Benefit still available for certain members of the military

In general, the first-time homebuyer credit is no longer allowed for homes purchased after April 30, 2010 (September 30, 2010, if you entered into a written binding contract before May 1, 2010). However, if you or your spouse were on qualified official extended duty outside of the United States for at least 90 days after 2008 and before May 1, 2010, you have an extra year to buy a home and claim the credit. In other words, you must buy the home before May 1, 2011 (before October 1, 2011, if you enter into a written binding contract before May 1, 2011).

Giving Gifts

What's taxable?

When you give cash or property to an individual, the gift is not taxable to that individual. However, if you give away too much, you may have to report the gift and pay gift tax.

The IRS allows you to give each individual up to $13,000 during the year without requiring you to report the gift or file a gift tax return. In addition, certain gifts do not count toward the $13,000 annual exclusion, such as amounts paid directly to qualifying educational institutions for tuition or medical expenses (including health insurance) paid directly to the person or the medical organization.

If you give more than $13,000 to one individual during the year, you must file a gift tax return to report the taxable gift. Your gift will be taxable to the extent the amount given exceeds $13,000. However, you can give up to $1 million in taxable gifts during your lifetime before you are required to pay any gift tax.

Coverdell Education Savings Account (ESA)

Time to roll it over into a 529 plan?

Section 529 plans may only be used to pay for qualified higher education (post-secondary) expenses. On the other hand, Coverdell ESAs may be used to pay for qualified higher education expenses or qualified elementary and secondary education expenses (K-12). However, unless a new law extends this provision, Coverdell ESAs can no longer be used for K-12 expenses after 2010.

After 2010, it may be wise to roll your Coverdell ESA into a 529 plan. A distribution from a Coverdell ESA that is used for qualified education expenses is nontaxable. A contribution to a 529 plan is considered a qualified education expense if the contribution is on behalf of the designated beneficiary of the Coverdell ESA. In general, the distribution must be "rolled over" by December 31 of the same year.

Ultimately, you can contribute more to a 529 plan. The annual contribution limit for Coverdell ESAs is currently $2,000/year. After 2010, this limit is set to drop to $500/year. On the other hand, 529 plans have no annual contribution limits.* In addition, you can often deduct contributions to 529 plans on your state income tax return. Also, it is generally easier to change beneficiaries for 529 plans, and funds in Coverdell ESAs must be spent by the time the beneficiary turns 30 or the earnings become taxable and subject to a 10-percent penalty.

* Contributions over $13,000 require a gift tax return to report the taxable gift.

Nonbusiness Energy Credit

Qualifying home improvements must be made in 2010

If you want to make energy-efficient home improvements to your principal residence and qualify for a nonbusiness energy credit, you have until December 31, 2010.

The credit equals 30 percent of the amount paid for:

- Qualified energy efficiency improvements (i.e., insulation, windows, doors, etc.); and
- Residential energy property costs (i.e., central air conditioners, natural gas furnaces, tankless water heaters, biomass fuel stoves, etc.).

For purposes of this credit, costs are treated as paid when the original installation of the item is completed. Thus, you cannot simply purchase the item before year-end; it must be installed on or before December 31, 2010, to qualify for the credit.

The credit is limited to a total of $1,500 for tax years 2009 and 2010. Thus, if you already claimed a $1,500 credit in 2009, you are not eligible for a credit in 2010.

Quik *Tips*

1	If you want to get reimbursed from a health flexible spending arrangement (FSA) or a health reimbursement arrangement (HRA) for over-the-counter drugs, you must do so on or before December 31, 2010. After 2010, you can only get reimbursed for prescription drugs and insulin.
2	Don't forget to take your required minimum distribution (RMD) for 2010. RMDs were waived for 2009 only.
3	The 0-percent capital gains rate is set to expire at the end of 2010. If you are in the 10- or 15-percent income tax brackets, consider selling capital assets that have been held more than a year and have substantially increased in value. After 2010, the long-term capital gains rates will be 10 percent and 20 percent (8 percent and 18 percent for assets held over five years).
4	In 2010, the adjusted gross income (AGI) limit on Roth conversions is gone. However, a modified AGI limit continues to apply to regular Roth IRA contributions. To avoid this, you can make contributions to a nondeductible traditional IRA and convert them to a Roth IRA in the following year (only paying tax on any earnings).
5	In the past, if you thought you would be eligible for the earned income credit (EIC) and you had at least one qualifying child, you could choose to get advanced EIC payments with your pay by completing Form W-5, *Earned Income Credit Advance Payment Certificate*, and giving it to your employer. Starting in 2011, the advanced earned income tax credit will be eliminated.

tions from other Roth IRAs and designated Roth accounts.

- Qualified rollover contributions from accounts other than Roth IRAs or designated Roth accounts.
- The remaining nontaxable portion of the qualified rollover contribution.
- Earnings on contributions.

If your Roth IRA has no regular contributions and only consists of amounts converted in 2010 plus earnings, any distributions before 2012 would be attributable to the conversion income and would have to be included in income in the year distributed.

Deductible IRAs

Reduce your taxable income while saving for retirement

If you are employed and an active participant in an employer sponsored retirement plan [i.e., §401(k), SEP, or SIMPLE IRA], you can still make a contribution to a traditional IRA. You can contribute up to $5,000 ($6,000 if 50 or older), but not more than your compensation for the year. If you file a joint return, your spouse can also make an IRA contribution based on your compensation (even if he or she has little or no compensation).

Whether or not the contribution is deductible depends on your filing status and your modified adjusted gross income (MAGI). If you are single and your MAGI is more than $66,000, you cannot deduct your contribution. If you are married filing jointly and your MAGI is more than $109,000, you cannot deduct the contribution made for yourself. However, if your spouse is not covered by an employer sponsored retirement plan and your MAGI is less than $177,000, part or all of your spouse's IRA contribution may be deducted.

Contributions for the year must be made by the unextended due date of your return. Thus, contributions for 2010 must be made by April 15, 2011. You can even file your return and claim an IRA deduction before the actual IRA contribution has been made as long as it is made on or before April 15, 2011.

2010 Roth Conversions

Any distributions before 2012 may need to be included in income

If you did a Roth conversion in 2010, the conversion income is generally spread over two years (unless you elect out of the two-year period). Half of the income is reported in 2011 and the other half is reported in 2012. However, be careful if you take any distributions from the Roth IRA in 2010 or 2011, because the conversion income may be accelerated or included in income sooner.

Distributions from a Roth IRA are treated as having been distributed in the following order:

- Regular contributions to the Roth IRA and rollover contributions from other Roth IRAs and designated Roth accounts.

IRA Rollovers

Be mindful of the one-year waiting period

If you don't like how your IRA is being managed, you can transfer it to another IRA with a different trustee. To make this a nontaxable transfer, you can either do a direct trustee-to-trustee transfer, or you can receive a distribution and roll it over within 60 days.

You can do an unlimited amount of trustee-to-trustee transfers during the year. However, there is a one-year waiting period between rollovers from one IRA into another. This means that no further rollovers can be made in the same year from either (1) the IRA from which the rollover was made; or (2) the IRA into which the rollover was made. Watch out! If another rollover has been made during this one-year period, the second IRA distribution is subject to tax, and may also be subject to the 10-percent early distribution penalty and the 6-percent excess contribution tax.