What's New for 2011?

Payroll Tax Holiday. Employees will pay only 4.2% (instead of the usual 6.2%) OASDI (Social Security) tax on compensation received during 2011 up to $106,800 (the wage base for 2011). Similarly, for tax years beginning in 2011, self-employed persons will pay only 10.4% Social Security self-employment taxes on self-employment income up to $106,800. In either case, the maximum savings for 2011 will be $2,136 (2% of $106,800) per taxpayer. If both spouses earn at least as much as the wage base, the maximum savings will be $4,272.

Stricter Rules for Energy Saving Home Improvements. You can claim a tax credit for energy saving home improvements you make this year, but stricter rules apply for 2011 than for 2010.

You can only claim a 10% credit for qualified energy property placed in service in 2011 up to a $500 lifetime limit (with no more than $200 from windows and skylights). What's more, the credit you claim for any year can't exceed $500 less the total of the credits you claimed for all earlier tax years ending after Dec. 31, 2005.

The amount you claim for windows and skylights in a year can't exceed $200 less the total of the credits you claimed for these items in all earlier tax years ending after Dec. 31, 2005.

The credit is equal to the sum of: (1) 10% of the amount you pay or incur for qualified energy efficient improvements (such as insulation, exterior windows or doors that meet certain energy efficient standards) installed during the year; and (2) the amount of the residential energy property expenses you paid or incurred during the year.

The credit for residential energy property expenses can't exceed: (A) $50 for an advanced main circulating fan; (B) $150 for any qualified natural gas, propane, or hot water boiler; and (C) $300 for any item of energy efficient property (advanced types of energy saving equipment, such as electric heat pumps, meeting specific energy efficient standards).

Two Mileage Reimbursement Rates for 2011. The optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) for business travel taking place **from January 1, 2011 through June 30, 2011 is 51¢ per mile.** This rate can also be used by employers to reimburse tax-free under an accountable plan, those employees who supply their own autos for business use, and to value the personal use of certain low-cost employer-provided vehicles.

The business travel mileage allowance increases 4.5¢ to **55.5¢ per mile for travel during July 1, 2011 through Dec. 31, 2011.**

The rate for using a car to get medical care or in connection with a move that qualifies for the moving expense for the first half of 2011 is 19¢ per mile. Both rates will also increase 4.5¢ for the last half of 2011 from 19¢ to 23.5¢ per mile.

Changed Rules for Health Plan Reimbursements. Beginning this year, the cost of over-the-counter medicines can't be reimbursed with excludible income through a health flexible spending arrangement (FSA), health reimbursement account (HRA), health savings account (HSA), or Archer MSA (medical savings account), unless the medicine is prescribed by a doctor or is insulin.

This new rule applies to amounts paid after 2010. However, it does not apply to amounts paid in 2011 for medicines or drugs bought before Jan. 1, 2011. Also, for distributions after 2010, the additional tax on distributions from an HSA that are not used for qualified medical expenses increases from 10% to 20% of the disbursed amount, and the additional tax on distributions from an Archer MSA that are not used for qualified medical expenses increases from 15% to 20% of the disbursed amount.

Partial Annuitization of Annuity Contracts. When you receive non-retirement-plan annuity payments from an annuity contract, part of each payment is a tax-free recovery of your basis (cost of the annuity contract for tax purposes), and part is a taxable distribution of earnings.

For amounts received in tax years beginning after Dec. 31, 2010, taxpayers may partially annuitize such an annuity (or endowment, or life insurance) contract. If you receive an annuity for a period of 10 years or more, or over one or more lives, under any portion of an annuity, endowment, or life insurance contract, then that portion is treated as a separate contract for annuity taxation purposes.

The net effect is that the annuitized portion is treated as a separate contract, and each annuity payment from that portion is partially a tax-free recovery of basis and partially a taxable distribution of earnings. Absent this rule, the payments might have been treated as coming out of income before recovery of any basis. The portion of the contract that is not annuitized is also treated as a separate contract and will continue to earn income on a tax-deferred basis.

Small Employers May Establish "Simple Cafeteria Plans". For years beginning after Dec. 31, 2010, small employers (those having an average of 100 or fewer employees on business days during either of the two preceding years) may provide employees with a "simple cafeteria plan". An employer that uses this type of plan gets a safe harbor from the nondiscrimination requirements for cafeteria plans as well as from the nondiscrimination requirements for certain types of qualified benefits offered under a cafeteria plan, including group term life insurance, benefits under a self-insured medical expense reimbursement plan, and benefits under a dependent ***care assistance program.***

Year-end Tax Planning Strategies during a Recession. Year-end tax techniques usually involve postponing income and accelerating deductible expenses to reduce taxes for the current year. But, because the economic downturn continued through 2011, some of us will have significantly less income in 2011 than we expect to have in 2012. Doing things in reverse (deferring expenses and accelerating income) may save more in taxes if you will be in a higher tax bracket in 2012 than in 2011. But, of course, you will have to factor in the time-value of money to see if this reverse strategy is truly worthwhile.

New Stock Broker Reporting Rules. Generally effective on Jan. 1, 2011, every broker required to file an information return reporting the gross proceeds of a "covered security" such as corporate stock must include in the return the customer's adjusted basis in the security and whether any gain or loss with respect to the security is short-term or long-term. The reporting is generally done on Form 1099-B, "Proceeds from Broker and Barter Exchange Transactions."

Assets Inherited in 2010 May Need Basis Allocations or Zero Estate Tax Election. The 2010 Tax Relief Act reduces estate, gift and generation-skipping transfer (GST) taxes for 2011 and 2012. It preserves estate tax repeal for 2010, but in a roundabout way: estates wanting zero estate tax for 2010 must elect that option, along with the less favorable modified carryover basis rules that were set to apply for 2010. Otherwise, by default, the estate tax is revived for 2010, with a $5 million exemption, a top tax rate of 35%, and a step-up in basis. Executors have until January 15, 2012, to make the election and/or allocate basis.

In the case of a married person who dies after Dec. 31, 2010, a deceased spouse's unused exemption may be shifted to the surviving spouse. WARNING: these generous rules are temporary—much harsher rules are slated to return after 2012.