

# U.S. INCOME TAX UPDATE FOR YEAR 2010

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Tax planning and compliance for the 2010 tax-filing season has commenced. As such, it is imperative that you familiarize yourselves with certain concepts regarding **both** U.S. and Israeli income tax law, especially recent changes, and how they may affect your personal situation. Proper tax planning and minimization of your taxes requires an analysis of many important issues, including the U.S. and Israeli foreign income tax credit rules, the foreign earned income exclusion rules, and also how the applicable provisions of the U.S. - Israel income tax treaty affects you. Delineated below are some areas of current U.S. tax law, which may impact upon your U.S. tax return filings due in 2010. Please note that under the U.S. child credit rules, you may be eligible to receive FREE, from the U.S. Treasury, up to **\$1000 per child per year**. (Please note that restrictions may apply and that a tax advisor should always be consulted in order to plan properly).

**U.S. Child Tax Credit** of up to **\$1,000 per eligible child** potentially results in FREE money to you courtesy of the federal government via a U.S. check or direct deposit to your U.S. bank account, even if no U.S. income tax is due. If applicable, this credit may also be available to offset any potential U.S. income tax liability. Taxpayers must have reportable earned income from wages or self-employment generated in Israel or in the U.S. in excess of \$3,000 to \$11,750, depending on the year you are filing. The earned incomes of both husband and wife can be combined even if one spouse is NOT a U.S. citizen. The non-citizen spouse requires a U.S. tax identification number (TIN), which can be acquired by filing a U.S. Tax Form W-7. Children must be U.S. citizens aged 16 and below and must possess a U.S. Social Security number. Please note that maximizing the child credit can be quite complicated since there are many factors to consider. **Amended returns may be filed back to the tax year 2006 (2006 amended returns must generally be filed by April 15, 2010).**

**U.S. Income Tax Rates** are 10%, 15%, 25%, 28%, 33% and 35% respectively. The lower rates of 10% and 15% are available for the following taxable income levels: Single: up to \$33,950; Married Filing Joint: up to \$67,900. Please be advised that under new U.S. tax rules, (often referred to as "the stacking rule"), investment income may be taxed at a higher bracket, for example, if the foreign earned income exclusion has been used.

**Foreign Tax Credits** may be utilized when Israeli or other non-U.S. earned income exceeds the U.S. foreign earned income exclusion, on Israeli investment or other income that is also taxed in the U.S. (and vice versa), or if you are filing for the U.S. Child Tax Credit. Conversely, since Israel also taxes worldwide income, the Israeli income tax authorities will generally provide you with a foreign tax credit on income that was sourced and first taxed in the U.S.

**Foreign Earned Income Exclusion** has been inflation adjusted and rises to \$91,400 per taxpayer. Thus, married taxpayers filing jointly, who meet certain requirements, may potentially exclude up to \$182,800 of foreign **earned** income per tax return. However, one spouse may not utilize the unused portion of the exclusion of the other spouse and by electing the exclusion you may preclude eligibility for the U.S. Child Credit. Please note that this exclusion applies only to work or self-employed income and does **NOT** apply to pension, investment income, rental or any other non-work income.

**Self-employed Individuals** need 40 quarters in order to qualify for future U.S. Social Security Retirement benefits. These quarters can be earned even while living in Israel. This is primarily accomplished by:

- i) being self-employed in Israel and reporting Israeli self-employment income on your U.S. income tax return,
- ii) working in Israel for a U.S. entity and receiving a Form W-2 (employee) or Form 1099 (independent contractor),
- iii) going to the U.S. to work as an employee (W-2) or as a self-employed individual (1099).

**Automatic Extensions** for taxpayers, who reside overseas, are available until June 15, 2010. Interest will be charged, however, from April 15, 2010 if there is a balance due on your U.S. income tax return and penalties are calculated from June 15, 2010. Filing an extension will extend the time to file until October 15, 2010. It is strongly recommended that taxpayers, who owe income tax but do not file by June 15<sup>th</sup>, pay their estimated tax balance due by said date, along with the filing of an extension. Regarding estimated taxes for the upcoming year, it is imperative that taxpayers pay them on a timely basis in order to avoid estimated tax penalties.

**U.S. - Israel Income Tax Treaty** states that U.S. citizens living as residents in Israel are generally eligible to **exclude** from their adjusted gross income **U.S. Social Security benefits** received. This provision may result in substantial tax savings and even large **REFUNDS** on your prior 3 years' income tax returns if you originally included Social Security benefits as taxable.

**State and Local Tax Refunds** may be available for taxpayers who may be unnecessarily filing resident State income tax returns after they moved to Israel. You should be aware that having a bank account, brokerage account or driver's license in a particular State does **NOT** automatically necessitate a tax filing in that State. However, if you have real estate, a business, commute to and work in a State, or have any other activity considered a nexus (strong connection) to a State, you would generally only file a **non**-resident income tax return in that State. **Big refunds** may be available in these situations.

**Alternative Minimum Tax** (AMT) rules were revised in 2005. As such, those taxpayers who previously were paying AMT, may now be able to claim a U.S. income tax credit for **100%** (previously the credit was for 90%) of the foreign tax they paid, thereby substantially reducing or eliminating their AMT liability.

**Long Term Capital Gains** (whether derived in the U.S. or in Israel) apply to assets held for **more than one year**. The maximum tax rate is 15% (from 2009-2010 the 5% rate for taxpayers in the 10% or 15% income tax bracket drops to 0%). Capital losses are still fully deductible against capital gains, and any capital losses in excess of capital gains may fully offset up to \$3,000 of ordinary income. Net capital losses in excess of \$3,000 may be carried over indefinitely to future years. A balanced portfolio, which we can discuss with you in conjunction with your overall tax planning, is an excellent way to prepare for market fluctuations.

**Qualified Dividends** are taxed from 0% to 15%, the same as long-term capital gains. Generally, U.S. taxes paid on U.S. investment income may be used to offset Israeli taxes (and vice versa) thus potentially avoiding double taxation. In order to realize your savings from qualified dividends, you should compare the U.S. tax on your dividend income, which is taxed at 5% to 15%, versus the U.S. tax on your interest income which may be taxed at up to the highest U.S. marginal tax rate.

**Standard Deduction** amounts have been increased as follows: Single - \$5,700; Married filing jointly - \$11,400. Taxpayers over the age of 65 may claim an additional deduction of \$1,100 each, if married, or \$1,400 if single. Anyone with deductions in excess of these amounts may itemize their deductions. Please note that mortgage interest, real estate tax (arnona), Israeli income taxes, and certain charitable contributions paid to Israel sources may be deductible.

**Personal Exemptions** have been increased to \$3,650. In some cases, **grandparents** may claim their **grandchildren** as exemptions on their income tax returns when they provide at least half the support of the grandchild. Certain limitations may apply including that the grandchild must live with the grandparent.

**Gifting of up to \$13,000** annually to your children or grandchildren is an excellent way to potentially reduce the value of your U.S. taxable estate as well as future U.S. estate income taxes. The gifting limit is \$26,000 if your spouse joins you in making the gift. The exclusion amount on taxable estates is \$3,500,000 for 2009.

**Tax Retirement Plans** still exist in the form of traditional IRA's and Roth IRAs, as well as other types of savings plans. Traditional and Roth IRA's allow for contributions of up to \$5,000 per year (\$6,000 if you are age 50 or over). Contributions to Roth IRAs can be made even after age 70 1/2. Roth IRA withdrawals are generally tax free if certain conditions are met and include a 5-year holding period and an age requirement of 59 1/2. Please note that potentially deductible IRA contributions can be made for taxpayers reporting compensation on their U.S. income tax return, including those taxpayers who are filing for the U.S. Child Credit.

**"First Time" Homebuyers** may still make an IRA withdrawal of up to \$10,000 if single, and \$20,000 on a jointly filed return (\$10,000 for each spouse's account) and not be subject to the 10% early withdrawal penalty. The penalty will generally not apply if the funds are used within 120 days to buy, construct, or reconstruct a personal residence. (In addition, there are other situations, such as for medical or educational reasons where penalties may also be avoided).

**Corporations** are potentially **excellent tax planning vehicles, especially in light of Israeli tax reform**. "C" Corporation tax rates are 15% on taxable income up to \$50,000, 25% from \$50,001 - \$75,000 and 34% from \$75,001 - \$100,000, with higher rates for higher taxable incomes. "S" Corporations and Limited Liability Companies ("LLC's") are called pass-thru entities and your pro-rata share of the entity's income is taxed at your individual income tax bracket.

**FBAR** If you own or have authority over a foreign financial account, including a bank account, brokerage account, mutual fund, unit trust, or other types of financial accounts, then you may be required to report the account yearly to the Internal Revenue Service. Under the Bank Secrecy Act, each United States person must file a Report of Foreign Bank and Financial Accounts (FBAR), if

1. The person has a financial interest in, or signature authority (or other authority that is comparable to signature authority) over one or more accounts in a foreign country, and
2. The aggregate value of all foreign financial accounts exceeds \$10,000 at any time during the calendar year.

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