

Tax Letter

Tax Gimmicks Congress love

(1) Refundable Tax Credits

I believe most people will not object to the fact that many taxpayers who qualify for one of the allowable tax credits may use them to offset 100% their Federal income tax. However, I do not believe that most people will agree that the amount in excess of their Federal tax liability should be paid to them as if they earned it.

Further, it may encourage tax fraud. Let's look at the most recent development – the first time home buyer's credit. It is offered as one of the "refundable" tax credits. Under this new set-up, an individual who owes no tax can collect \$8,000 refundable credit payment by claiming he bought a "first" home in 2009 and using Form 5405 to collect it. He is required to send this Form 5405 to the IRS together with his Form 1040 (his tax return). But he is not required to submit any proof that he actually bought the home and qualified as the "first time home buyer". In fact, he is not even required to state in the Form 5405 or anywhere in his Tax return that he has proof. He will not be caught for fraudulently claiming the \$8,000 refund check unless the IRS chooses to audit his tax return. The probability is very low, however. It sounds unbelievable, but it is true.

(2) Double Taxation on Social Security Benefits

Do you know you pay an additional Federal tax of 6.2% on the amount you earned as an employee, and 12.4% on the amount you earned as a self-employed individual. This is the amount either taken out of your paycheck or you deposited it yourself. It is known as the Social Security (FICA) tax. Then, when you retire and begin to receive your benefits from it, up to 85% of the benefits you receive can be taxed *again*. This is double taxation.

Yes, retirees who are at very low income levels won't have to pay this double tax, but those who are further up the income scale must pay income tax again anywhere from 50% to 85% of the Social Security benefits received. Certainly, it is unfair. But our Congress (Democrat or Republican) do not care because they do not have to pay for this double tax themselves when they retire from Congress.

(3) Deceptive "Phase-Outs"

Another one of their gimmicks is to create a tax deduction. While they are bask in the glory of good publicity, they stab the taxpayers in the back by taking it away claiming that the taxpayers' income are "deemed" to be "too high." Such tricks including but not limited to personal exemptions, schedule "A" itemized deductions, child tax credit, higher-education tax credits, and many, many more are taken away by some "phased-out" designs which rise with

your gross income. Therefore, these “phase-outs” are in fact tax increases that Congress has no nerve to admit.

If higher taxes are necessary, Congress should raise them in a straightforward and transparent manner. Of course, many members of Congress may fear that such honesty would hurt their chances for re-election. They might be right, but there should be no excuse. Deception is deception. Honesty is honesty.

(4) Alternative Minimum Tax (AMT)

The AMT was originally conceived as an alternative individual income tax which forced super-high-income people, who manage to take advantage of many tax breaks allowed by Congress, to pay at least some tax -- like a minimum tax. I believe that most people have no problem with this concept. But over the years, AMT has evolved into a tax that primarily tax the middle-income people who have lots of kids and pay lots of State and Local Taxes. To avoid ruffling the feathers of a large number of voters, Congress would rather work around the AMT rules (known as annual patches) every year to prevent millions more taxpayers from getting hit by this AMT tax. Why not simply repeal it and be done with it? Politicians want to keep the AMT around as a backup revenue source -- just in case. This is a bad tax policy, because it is deceptive. If Congress wants to squeeze more tax revenue out of the people, they should be honest about it and increase the tax rates or eliminate the deductions. This way, all of us will understand exactly what they are doing.

(5) Health-Insurance Premiums Paid by Employees

Employees who paid for their portion of health insurance through payroll deductions can not deduct the premium they paid as an above the line deduction. They can only do it as an itemized deduction subject to the 7.5% AGI (Adjusted Gross Income) limitation. Meanwhile, employees with better benefit packages get tax-free health coverage, and self-employed taxpayers are allowed to write off their health-insurance premiums above the line. This is completely unfair. However, our Congress are very happy to keep it this way, therefore, they are not going to change it. They just don't care about you. It's that simply.

If you like to discuss the content of this letter further, please give us a call at 415-381-0681.

Sincerely,

Cho F. Chan CPA Inc.