2011 TAX YEAR; April 2012
FREQUENTLY ASKED QUESTIONS

AVOIDING AN IRS AUDIT

I'm an honest taxpayer, but I've heard that the IRS is increasing the number of audits the agency will perform this year. What is the IRS looking for?

Most returns are selected for audits by an IRS computer-generated program that compares the deductions you are claiming on your return to other returns in your income bracket. To arrive at a discriminate function (DIF) score, the formula also considers where you live, the size of your family, and how your income is earned. For example, if you were to report income of $60,000, live in an exclusive neighborhood with your family of six, and claim $15,000 in mortgage interest, the IRS may want to chat with you.

How you generate your income may increase the likelihood of your return being selected for an audit. For example, your chances rise sharply if you file Schedule C. That's because the IRS is well aware that self-employed workers have more opportunities to hide income and to transform personal expenses into business deductions. Workers who receive much of their income in cash, such as those in the gaming, food service, and entertainment industries, also can expect a higher level of scrutiny.

In recent years, the IRS has enhanced its document-matching program, which compares the information sent to the IRS by taxpayers' employers, clients, and financial services providers to what's reported on the return. To avoid attracting the attention of IRS auditors, make sure the numbers you report accurately match the information the IRS receives. Check your W-2 wage statements and Form 1099s as soon as you receive them and, if the information is incorrect, ask the issuer to send revised forms to both you and the IRS.

Be sure you record the correct Social Security numbers for yourself, your spouse, and your dependents. The government uses Social Security numbers to check whether a child is claimed as a dependent by more than one person. It's also important that you review the Social Security numbers on your W-2 forms. According to the IRS, an incorrect number on a Form W-2 results in the return being categorized as "not processible." In such cases, a refund is delayed until the IRS obtains the correct Social Security number.

Verifying the accuracy of the math on your return is one of the easiest ways to escape a second look by the IRS.

Be careful about claiming deductions for donations not in line with your income. If you report income of $50,000 and donate $10,000, you may be doing a noble thing, but the IRS is likely to want to know more. In such a case, you may want to include support documentation with your tax return.

Although the rules governing who can qualify for the home office deduction were relaxed in 1999, they are still complex and apply to only a limited number of individuals. While you certainly should claim the home-based office deduction if you operate your business from your home and meet all the requirements, be aware that this might invite IRS scrutiny. Read carefully IRS Publication 587, Business Use of Your Home, before deducting expenses associated with a home office.

CHILD AND DEPENDENT TAX CARE CREDIT

My husband and I both work, and we pay for daycare for our 11-year-old son and our 8-year-old daughter. Do we qualify for any tax breaks?

The child and dependent care tax credit benefits families who, in order to work or look for work, pay someone to care for a dependent child under age 13. The credit also covers care of a spouse or a dependent of any age that is physically or mentally incapable of self-care.

My sister watches my children in the daycare center she runs out of her house. Can I still take advantage of the child and dependent care tax credit?

Almost any type of care qualifies for the credit, regardless of whether it is provided in your home, the residence of a care provider, or at a daycare center or child-care facility. However, no credit is allowed for the expense of sending a child or another dependent to an overnight camp. In addition, the caretaker cannot be someone you can claim as your dependent, or a son or daughter under age 19 at the end of the year.

How much is the child and dependent care tax credit worth?

The child and dependent care credit is a percentage, based on your adjusted gross income (AGI), of the amount of work-related child-care expenses you paid during the year. In general, the higher your child-care expenses and the lower your income, the larger your tax credit. You may take the child and dependent care credit even if you do not itemize your deductions.

There is a dollar limit on the expenses toward which you can apply the credit. For 2011, maximum qualifying expenses for the child and dependent care credit is $3,000 for taxpayers with one qualifying individual and $6,000 for taxpayers with two or more qualifying individuals. The percentage of the expenses you can take ranges from a low of 20 percent to a high of 35 percent of expenses paid during the year, depending on your AGI.

Who is eligible to claim the child and dependent care tax credit?

To be eligible to claim the tax credit, you (and your spouse, if you are married) must have paid more than half the cost of maintaining the home in which you and the child or dependent lived. Eligible expenses are also limited by your earned income. In the case of a married couple, both spouses must have earned income from wages, salaries, tips, etc., unless one spouse is a full-time student or is physically or mentally incapable of self-care. The earned income of you or your spouse, whichever is lower, determines the maximum amount of expenses eligible. Finally, the credit cannot be claimed by anyone using the married, filing separately status.

I pay for my daycare with money from my Flexible Spending Account. Do I still qualify for the child and dependent care tax credit?

You cannot use both the tax credit and a dependent care Flexible Spending Account (FSA) for the same expenses. If you receive employer-provided dependent care benefits, the amount must be subtracted from the child-care expenses claimed under the credit. If in 2011, you use a reimbursement account to pay for $3,000 of the cost to care for two children, you may be eligible for a tax credit of $3,000 based on the difference between your FSA contribution and the maximum tax credit for which you qualify. The amount of any employer-provided dependent care benefits should be shown in Box 10 of your W-2 form.

How do I claim this credit on my taxes?
If you qualify for the child and dependent care credit, you must file either Form 1040 or Form 1040A. If you're filing Form 1040, complete and attach Form 2441 to your return. Form 1040A filers must use Schedule 2. You cannot use Form 1040EZ if you are claiming the child and dependent care credit.

CLAIMING DEPENDENTS

Who can I claim as a dependent on my tax return?

Taxpayers can apply the same definition of a dependent when determining their eligibility for the dependency exemption, head of household filing status, earned income credit, child tax credit, and child and dependent care tax credit.

To claim someone as a dependent, he/she must meet the following four criteria:

1. The Relationship Test

The dependent must be your child or a qualified relative. Qualified relatives include adopted children, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendent of one of these relatives.

2. The Residency Test

To qualify as your dependent, the child must live with you for more than half of the year. Time spent at school or vacation still counts as time lived at home, as does time away from home for medical care or military service. In addition, any time spent at a juvenile detention facility also counts as time lived at home.

3. The Age Test

This varies by tax benefit.

Dependency exemption, earned income credit and head of household filing status

To qualify for these tax benefits, the dependent child must be under age 19 by Dec. 31, 2011; under age 24 by Dec. 31, 2011, if the dependent is a student; or any age if he/she is permanently and totally disabled. There is no age requirement for the qualifying relative; however they must have a gross income of less than $3,650

Child tax credit.

To qualify for the child tax credit, the dependent must be under 17.

Credit for child and dependent care expenses.

Children under 13 and permanent and totally disabled children of any age qualify for this credit.

4. The Support Test

To qualify as a dependent, a child cannot have provided more than 50 percent of his or her own support during the year. Support includes the cost of shelter, food, clothing, education, health care, transportation, and similar necessities.

Exception

If determining eligibility for the earned income credit, the support test does not apply.

I am divorced. Can I claim my child as a dependent?

In the case of divorced parents, the general rule is that the custodial parent claims the dependency exemption even if the non-custodial parent paid most of the child support. However, the custodial parent may agree to waive the exemption by signing Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents. The non-custodial parent attaches this form to his or her return and claims the exemption.

My sister and I help take care of my 80-year-old mother. Who can count her as a dependent?
If two or more persons together provide more than 50 percent of an individual's support, but no one member of the group provides more than half, the individuals may enter into a multiple support agreement. Under this agreement, the dependency exemption may be claimed by any person providing more than 10 percent of the individual's support. If you are that person, you must have each person who contributes over 10 percent sign IRS Form 2120, Multiple Support Declaration, which you submit with your tax return. For example, if you and your sister determine that you can claim your mother as a dependent this year, your sister would sign Form 2120 and waive her right to claim your mother as a dependent.

How much is a dependency exemption worth?
In general, for 2011, each taxpayer may claim a personal exemption of $3,700. If you are married and file a joint return, you and your spouse each claim a personal exemption. You can claim an exemption for your spouse, even if he or she died during the tax year, provided that you did not remarry. In addition, a taxpayer is entitled to an additional $3,700 dependency exemption for each qualified dependent. A child qualifies for an exemption, even if he or she is born on the last day of the year.

My husband and I have a combined income of $220,000. Do we still qualify for dependency-related deductions?
For 2011, there are no phase-out exemptions.

To claim an exemption for a dependent, you must use Form 1040 or Form 1040A and include a Social Security number for each dependent.

DEDUCTIONS

Should I itemize this year?

The only sure way to determine which method saves the most tax dollars is to run the numbers. Use Schedule A to list all your deductible expenses and compare the total to the standard deduction for your filing status. If your actual itemized expenses exceed the standard deduction, you'll save money by itemizing.

How much is the standard deduction this year?

If you are single or married filing separately, your basic standard deduction for 2011 is $5,800; head of household – $8,500; or married filing jointly or qualifying widow or widower – $11,600. If you're over age 65 at the end of the tax year or legally blind, you're entitled to an additional standard deduction, depending on your filing status.

What expenses can I itemize?

Taxpayers can usually reduce their taxes by itemizing expenses for mortgage interest, taxes, charitable contributions, medical care, casualty losses, and other miscellaneous deductions. If you work with a professional tax preparer, you may deduct the fees you paid to have the return prepared.

Casualty and theft losses are deductible in the year the loss was discovered. Uninsured losses caused by theft, vandalism, fire, storm, or similar causes are deductible only if you itemize and only to the extent they exceed 10 percent of your adjusted gross income (AGI). The first $100 in losses for each event is nondeductible.

Texans won't want to overlook the state and local sales tax deductions. Texas taxpayers who itemize their tax deductions may either save their receipts or use the IRS sales tax tables to determine how much to deduct.

Other common deductible expenses include home mortgage interest expense on up to $1 million in home acquisition debt ($500,000 for MFS) and $100,000 ($50,000 MFS) in home equity debt, state and local income and property taxes, and charitable contributions to qualified organizations.

Gifts of $250 or more require a statement from the charitable organization showing the amount contributed and whether you received any goods or services in return. A canceled check is not sufficient proof. If you give a non-cash gift worth more than $5,000, you must get a qualified appraisal to deduct it.

No deduction is allowed for most contributions of clothing and household items unless the donated property is in good used condition or better.

Medical expenses exceeding 7.5 percent of your AGI also may be deducted. For AMT, medical expenses must exceed 10% of AGI to be deducted. Examples of deductible medical expenses include fees for doctors, dentists, chiropractors; insurance premiums for medical and dental insurance; prescription medications; hospital care; X-ray and laboratory services; and other related costs.

Miscellaneous expenses exceeding 2 percent of your AGI are deductible. This category includes un-reimbursed employee business expenses, investment expenses, and tax preparation fees, among others.

I’ve heard CPAs talk about bunching my deductions. What is it and how does it work?
If you tallied all qualified expenses and came up short for 2011, don’t assume you can’t itemize in future years. Consider alternating between taking the standard deduction one year and “bunching” deductible expenses into the year you itemize. Bunching refers to the process of timing your expenses so that they are higher in one year and lower the following.

The easiest deductions to juggle between tax years are charitable contributions, state and local income and property taxes, and your January home mortgage payment. For example, you could double up on your charitable contributions and make them every other year rather than annually. In the year you decide to itemize, you can make your January mortgage payment in December to boost your mortgage interest expense. You should also try bunching deductions subject to AGI-based limits like medical and dental expenses and miscellaneous itemized deductions. Timing elective medical procedures, such as braces and laser eye surgery, is a common way to qualify for the deduction.

The AGI-based phase out of itemized deductions does not apply for 2011.

I’ve already filed my return, but I just realized that I could have gotten a refund by itemizing my deductions. What should I do?
If you are willing to recalculate your taxes, you can file an amended return. Form 1040X will let you negate your original standard deduction and, in its place, list all the money-saving deductions you should have taken. Just be sure you still have the paperwork and receipts to substantiate your deductions in the event of an audit. Generally, tax returns must be amended within three years of the original filing deadline. A CPA can help you correct your past returns and provide you with additional strategies for timing your deductions to maximize your tax savings.

EARNED INCOME CREDIT

I have a daughter who lives with me, and I earn $26,000 per year. Can I qualify for the earned income credit?

The EIC is a special refundable tax benefit for workers earning low to moderate incomes. To qualify, you must be a U.S. citizen or resident alien for the entire year, have lived in the U.S. for more than half of the year, and have a valid Social Security number.

For 2011, taxpayers with three or more qualifying children are allowed a higher EIC credit percentage (45%). In addition, the threshold amounts for MFJ taxpayers are increased so they are $5,000 more than those for other taxpayers.

If you are married, your filing status cannot be "married, filing separately." You cannot be a qualifying child or be claimed as a dependent on someone else's return. If you do not have a qualifying child, you must be at least age 25 but under age 65 at the end of the year in which you claim the credit.

If you have no children, your adjusted gross income (AGI) or earned income, if greater, must be less than $13,660 ($18,740 for married filing jointly). If you have one qualifying child, your income must be less than $36,052 ($41,132 if filing jointly). With two qualifying children, the amount must be less than $40,964 ($46,044 if filing jointly). With three or more children, the amount must be less than $43,998 ($49,078 if MFJ).The income limits rise each year to keep pace with inflation.

To be eligible, your investment income (interest, dividends, capital gains, etc.) must be $3,150 or less in 2011. You cannot claim the EIC if you file Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.

How much is the credit?

For 2011, the maximum credit amount is $3,094 for taxpayers with one qualifying child, $5,112 for filers with two qualifying children and $5,751 with three or more qualifying children. If there are no qualifying children, the maximum EIC is $464.

How do I claim the credit?

To claim the credit, attach Schedule EIC to your tax return. Most people can use the worksheet included in the instructions for Form 1040, Form 1040A or Form 1040EZ to compute the credit. You can claim the EIC on Form 1040EZ only if you do not have qualifying children. Taxpayers with more complex returns must figure their credit using the worksheet in IRS Publication 596, Earned Income Credit (EIC). If you choose to have the IRS figure the credit for you, carefully follow the steps in the instructions for your form or refer to Publication 596.

EDUCATIONAL EXPENSES

I'm working my way through college, and I've taken a few classes at the local community college. Do I qualify for any tax breaks?

The American Opportunity Credit can be claimed for four post-secondary education years and required course material costs are included as qualified expenses.

This credit of a maximum of $2,500 per student is available to individuals with income of $80,000 or less or $160,000 for married couples who file a joint return. The credit is phased out for higher incomes.

My husband is in graduate school. How do we use the Lifetime Learning Credit?
The less restrictive Lifetime Learning Credit lives up to its name. It targets not only college, graduate, and professional students, but also adults going back to school or taking courses to improve or update their skills. Students do not have to carry a minimum course load to be eligible, and there is no limit on the number of years the credit can be used.

For 2011, a family could claim a 20 percent tax credit for the first $10,000 of qualified tuition and fees. This makes the maximum Lifetime Learning Credit $2,000 per return. Unlike the American Opportunity Credit, the top Lifetime Learning Credit is determined on a family basis. Regardless of how many family members are taking courses, the maximum credit is $2,000.

My wife is going to law school part-time at night, and my son is in his first year at Texas Tech. Can I take both the Lifetime Learning Credit and the American Opportunity Credit this year?
You can take both the American Opportunity Credit and Lifetime Learning Credits in the same year if your wife qualifies for the Lifetime Learning Credit and your son qualifies for the American Opportunity Credit. You cannot take both the American Opportunity Credit and Lifetime Learning Credits for the same student in the same tax year. However, you now can take the American Opportunity and Lifetime Learning Credits in the same year that you take a distribution from an Education IRA or make a tax-free withdrawal from a state-sponsored Section 529 plan. Just be sure that the distribution isn't used for the same expenses for which the credit is claimed.

Our family makes too much money to qualify for either the Lifetime Learning Credit or the American Opportunity Credit, but we have two kids in college. Are there any tax deductions out there for taxpayers like us?
Taxpayers with incomes too high to benefit from the American Opportunity Credit or Lifetime Learning Credits may be able to take advantage of the tuition and fees deduction. For 2011, you qualify for the maximum deduction of $4,000 if your modified adjusted gross income (MAGI) is not more than $65,000 for single filers and $130,000 for married taxpayers filing jointly. If you're a single filer and your MAGI is more than $65,000 but not more than $80,000, your deduction is limited to $2,000. The $2,000 deduction also applies to joint filers whose MAGI is higher than $130,000, but not more than $160,000.

No tuition and fees deduction is allowed if your MAGI exceeds $80,000 for single filers and $160,000 for joint filers.

The $4,000 is the annual maximum, regardless of how many students in your family qualify. The tuition deduction may be claimed whether or not you itemize your deductions.

Please note: this provision originally expired at the end of the 2005 tax year. Congress extended the deduction after the IRS had already printed its tax forms so there are special instructions on how to claim this deduction.

According to the IRS, you must file Form 1040 to take this deduction. The deduction is claimed on Form 1040, line 34, “Domestic production activities deduction.” Enter "T" on the line to the left of that line entry if claiming the deduction for tuition and fees, or "B" if claiming both a deduction for domestic production activities and the deduction for tuition and fees. For those entering "B," you must attach a statement with a breakdown of the amount claimed for each deduction.

E-FILING

I'm thinking about e-filing my return this year. Should I do that or should I file the old-fashioned way?

Accuracy, speed, and security are among the chief benefits of electronically filing your income tax return. With e-file, there is no need to submit a paper return to the IRS and even payments and refunds can be transmitted electronically.

According to the IRS, less than 1 percent of electronically prepared returns contain errors as compared to roughly 20 percent of paper returns. That's because, in most cases, electronic tax filing software does the math for you and alerts you to potential errors before you file. This greatly reduces the chance of getting an error letter from the IRS.

In a hurry for your refund? You'll get it much faster when you file electronically. Typically, you can expect to receive your refund in approximately three weeks from the acknowledgement date and even sooner when you have your refund credited directly to your bank account.

With e-filings, there's no need to worry about your return getting lost in the mail. In fact, within two business days of receiving your return, the IRS will acknowledge its receipt. And that's not all. If there is an error, it will be bounced back to the transmitter within two days, with an explanation of the rejection reason. This allows you to quickly resolve the error and resubmit. By comparison, the same process for paper returns could take weeks or even months, delaying your refund. And by choosing to have your refund deposited directly to your bank account, you eliminate the concern of having your income tax check lost in the mail or stolen.

How do I e-file?

You have two e-filing choices: you can have a CPA or another professional tax preparer complete your return and submit it electronically or you can prepare the return yourself and arrange to have it submitted to the IRS. To complete the return on your own, you will need a computer, modem, and commercial tax preparation software. You can purchase the software and install it on your computer, or if you prefer, you can download tax preparation software from the Internet and prepare your return offline or use a Web-based system to prepare your return online.

Once your return is completed, you will need to submit it via modem to an authorized e-file provider who takes the file you send, converts it to the IRS-required format, and sends it to the IRS. To find an authorized e-file provider in your area, go to the IRS Web-site at www.irs.gov and click on the e-file icon.

How do I sign my return when I e-file?

The most convenient way for you to "sign" your electronic return is to use a self-selected PIN (personal identification number). With a PIN, there is no paper signature document to send in. You do not need to register the PIN with the IRS, nor do you need to contact the IRS to get it. When you use one of the commercially available tax software packages that support the self-selected PIN option, you will be guided through the process of entering your own PIN. If you use a tax professional, the preparer will help you.

If you choose not to select a PIN, you can simply sign the paper signature document, Form 8453, U.S. Individual Income Tax Declaration for an IRS e-file Return, and mail it to the IRS.

I owe money this year, but I still want to e-file. What should I do?
A CPA can file your return electronically at any time during the filing season, and you can authorize the IRS to debit your checking or savings account on April 17. If you prefer, you can mail a check to the IRS by April 17 or pay by credit card. If you choose the credit card option, be aware that you may be charged a convenience fee. Although the IRS does not charge for e-filing, the provider may collect a fee, depending on the specific services you request.

I've already e-filed my return this year. What am I supposed to do with all of my W-2s and receipts?
When you file electronically, you do not need to mail the IRS supporting documents, such as your W-2 or receipts for charitable contributions. However, CPAs caution you to retain your receipts and other supporting documents because you'll need to produce them in the event of an IRS audit. CPAs also recommend that you print a copy of your return for your records.

I've heard about the IRS Free File program. What is it, and how do I take advantage of it?
The IRS and a group of tax software companies have partnered to offer free e-filing for taxpayers with an adjusted gross income of $57,000 or less in 2011. You can find out more about Free File on the IRS Web site, www.irs.gov.

FILING AS HEAD OF HOUSEHOLD

I am a single mother with a 7-year-old son. Should I file as head of household?

Taxpayers who qualify as head of household for tax filing purposes may pay less tax than single individuals supporting themselves. As head of household, your tax rate will be lower than the rates for single or married filing separately, and you will also receive a higher standard deduction. If you are unmarried at the end of the year, maintain a household for a child, parent, or other relative, and are a U.S. citizen or a resident alien, you may be eligible.

To qualify, you must have been unmarried on the last day of 2011. You also must have paid more than 50 percent of the cost of maintaining the household for a qualifying relative for the year, and you must have maintained your household for a qualifying person who lived with you for more than half the year.

I separated from my wife in November. Can I file as head of household?

To qualify for the head of household filing status, you must have been unmarried on the last day of 2011. You are unmarried if you are single or legally separated from your spouse or under a divorce or separate maintenance agreement.

You may be able to file as head of household even if you were not divorced or legally separated from your spouse in 2011, if your spouse was not a member of your household at any time during the last six months of the year; you are filing separate returns; and you maintained a household for more than half the year for a dependent child, stepchild, or adopted child and you furnish more than half the cost of maintaining the household.

How do I file as head of household?

To file as head of household, you can use Form 1040 or Form 1040A. Indicate your choice of this filing status by checking the appropriate box, and use the head of household column in the Tax Table to compute your tax. If you're not sure whether you qualify for filing as head of household, a CPA can help you determine your eligibility.

LAST-MINUTE TAX QUESTIONS

What documents should be included with my tax form?

Generally, the only forms that need to be attached are your W-2 and certain 1099 forms.

I found a mistake on one of my 1099 forms and haven't received a corrected one yet. What should I do?

You have two choices. Either pay the amount of tax that is due and file for an extension or file your return and send an amended return later with an explanation.

Filing an extension

How do I get an extension to file my tax return?

All you need to do is file Form 4868 to obtain an automatic six-month extension. This will eliminate any late-filing penalties, but you will still need to include any taxes you owe.

Paying your tax bill

What if I can't pay the balance of my taxes by April 17?

If you can show undue hardship, complete and mail Form 1127 on or before April 17 to extend the time of payment for up to six months. Your application must be accompanied by evidence supporting undue hardship, a statement of assets and liabilities, and receipts and disbursements for three months prior to the original due date of the return. If you don't think you'll be able to pay off your outstanding tax bill in full within six months, you can file Form 9465 to request an installment agreement. However, you will be charged interest on your outstanding tax balance. As an alternative, you may want to consider getting a loan from a family member, friend, or bank.

Getting your return to the IRS by April 17

My tax return won't be ready until April 17. What's the best way to get it to the IRS?

E-file your return, or use the U.S. Postal System. As long as your return is postmarked on April 17, it will be deemed filed on time.

REFUNDS

I've already filed my return, but I haven't received my refund. How can I find out the status of my tax return?

"Where's My Refund?" is the quickest way to check on a refund, especially for taxpayers who e-file their tax return. E-filers can begin tracking their refund online within 48-72 hours of filing their electronic return. Paper return filers can start checking online about three to four weeks after their return is mailed.

The "Where's My Refund?" service is available on the IRS Web site, www.irs.gov. Simple online instructions guide taxpayers through a process that asks for their Social Security number, filing status and the exact amount of their refund – all information shown on their tax return.

Once the information is submitted, results can include one of several responses, including:

- That a return was received and is in processing;
- The expected mailing date or direct deposit date of the taxpayer's refund; or
- Whether a refund has been returned to the IRS because it could not be delivered.

I always have my refund directly deposited into my savings account. This year, I want to split my refund up between my checking account, savings account and IRA. Can I do that?

Yes, you can. You can now split your refund into up to three accounts held by up to three different U.S. financial institutions, such as banks, mutual funds, brokerage firms or credit unions. You may still have your refund directly deposited into one account if that's your preference. To split your direct-deposit refunds among two or three different accounts or financial institutions, you'll have to complete the new Form 8888, Direct Deposit of Refund to More Than One Account.

TAX BREAKS FOR THE DISABLED

I'm disabled. What kind of tax breaks do I qualify for?

People with disabilities are eligible for a number of tax breaks. These include tax deductions and credits that can offset some of the costs associated with managing a physical or mental disability. Additionally, certain income is tax free to qualified disabled individuals. If you or someone you know suffers from a disability, take the time to understand how the tax law may help to ease some financial burdens.

I've heard that disabled taxpayers can receive income that's not taxable. Is this true?

Some payments made to taxpayers with disabilities are not taxable. These payments include amounts received under a workers' compensation act for a job-related illness or injury and veteran's disability benefits from the government. Other tax-free income includes damages awarded for physical injury or illness; benefits paid under a no-fault car insurance policy for loss of income or earning ability as a result of injuries; and compensation received for permanent loss of the use of some body part or function. Like regular Social Security payments, the taxation of Social Security disability payments is based on the recipient's income level.

Income received from an accident or health insurance plan for your disability may or may not be taxable depending on who paid for the plan. If your employer footed the bill, your benefits are taxable; if you paid the entire cost, you need not report as income any disability payments from the plan. If both you and your employer shared the cost, you report as income only the amount your employer paid for your disability. Your employer should be able to give you specific details.

As a disabled taxpayer, I have a considerable number of medical expenses. Which of these are deductible?

Medical expenses exceeding 7.5 percent of a taxpayer's adjusted gross income (AGI) are deductible. In addition to the costs of health insurance, physician fees, hospitals, and prescription drugs, the disabled person can deduct costs related to special equipment such as motorized wheelchairs, hand controls on a car, special telephone equipment, and the cost of a guide dog. Also deductible are expenses for special schools for a physically or mentally handicapped child and for schools that teach skills such as sign language, Braille, or lip reading.

Certain home improvements removing structural barriers to accommodate a disabled person may also be deducted as medical expenses. Such costs include entrance and exit ramps, widened doorways, lowered kitchen equipment and cabinets, and modifications to bathrooms. The full cost of such structural improvements, regardless of whether or not they increase the home's value, are added to other medical expenses and the total is deductible to the extent that it exceeds 7.5 percent of AGI. Capital expenditures for home improvement for medical care reasons are deductible only to the extent the cost of the improvement exceeds any increase in the property's value.

If you are disabled, you may be able to claim as an employee business expense (rather than as a medical expense subject to the 7.5 percent AGI floor) certain un-reimbursed impairment-related work expenses necessary to satisfactorily perform your job, as long as they are not used, except incidentally, for personal purposes. For example, an employee confined to a wheelchair that needs someone to accompany him or her on business trips may deduct the person's travel costs.

Here's another important point: Although unreimbursed employee business expenses are generally deductible only to the extent that they, together with other miscellaneous expenses, exceed 2 percent of your AGI, this rule is waived for certain impairment-related work expenses.

What about the tax credit for disabled Americans?
If you are either over the age of 65 or under age 65 and retired on permanent and total disability, you may qualify for a tax credit. According to the IRS, you are permanently and totally disabled if you cannot engage in any substantial gainful activity because of your physical or mental condition. A physician must certify that the condition has lasted or can be expected to last continuously for 12 months or more, or can be expected to result in death. You qualify for the credit only if you have taxable disability income.

Qualified taxpayers who, in order to work or look for work, pay someone to care for a spouse or dependent who is physically or mentally unable of self-care, also may be eligible for a tax credit for a portion of the cost paid for such care.

TAX PLANNING FOR 2012

I know I'm not saving enough for retirement, and I've heard there are some catch-up provisions out there for people like me.

If you participate in an employer-sponsored retirement plan, try increasing your contribution by 1 or 2 percent. You probably won't miss the money and if your contribution qualifies for an employer match, you'll be getting more "free" money. If your company doesn't offer a qualified retirement plan, set up and contribute to an IRA instead.

This year, you can contribute up to $16,500 to most 401(k), 403(b), and 457 plans. If you're 50 or over, you can contribute an extra $5,500 to help you catch up. The maximum contribution to either a traditional or Roth IRA is $5,000 or $6,000 for those 50 or older. Note: additional income restrictions apply for Roth IRA contributions.

I'm debating about whether I should sell some stock, but I know I have to think about capital gains taxes.

While you should never make investment decisions based solely on tax considerations, proper planning can reduce your tax bill significantly. For example, if it makes sense from an investment standpoint, wait to sell appreciated assets until you have met the one-year holding period to qualify for long-term capital gains treatment.

Timing losses to offset your gains is another tax-reducing strategy. Capital losses can be used to offset any capital gains you have, plus up to $3,000 of other income, such as salary. Any excess loss can be carried over to a future year.

I do crafts on the side, and I want to begin selling some of my work this year. What kind of tax issues will I face?

You may be able to turn your hobby into a business and write off business expenses. To qualify, you must be able to demonstrate that you engaged in the activity for a profit. This means conducting the activity as a business, with good records and a separate bank account. The IRS will expect your sideline business to show a profit in three out of five years, or you will have to prove your profit motive in order to deduct losses.

I'm worried that I might get tripped up by the alternative minimum tax exemption this year. What should I do?

The AMT exemption has increased to $74,450 for married taxpayers filing jointly and $48,450 for single or head of household filers. Originally intended as a way to prevent high-income taxpayers from not paying income taxes, it wasn't indexed for inflation and continues to catch more and more middle-class taxpayers.

Be aware that some personal credits are no longer allowed against the AMT. These credits include the dependent care credit, credit for the elderly and permanently and totally disabled, mortgage interest credit, residential energy credits and the Hope and Lifetime Learning credits.

The IRS offers an AMT Assistant to help you figure out if you're required to pay the AMT for the tax return you're filing in 2012 based on your 2011 income: http://www.irs.gov/pub/irs-pdf/i6251.pdf.

My husband and I would like to give each of our grandchildren some money, but we don’t want to get caught by the gift tax. What’s the maximum amount we can give to our family?

You can give up to $13,000 to as many people as you’d like without filing a gift tax return with the IRS. Spouses have separate annual exclusions, meaning you and your husband can each give up to $13,000 to each grandchild without triggering the gift tax. As long as each grandchild’s combined gift is less than $26,000 ($13,000 from you and $13,000 from your husband), there’s no need to file a gift tax return.