

## Re: 2009 Year-End Tax Planning

12/04/09

To our valued clients:

Our office knows that 2009 has been a difficult year for many of our clients due to the economic downturn. Although there are signs of recovery, it is expected that a full recovery is still some years away. You may be surprised to learn that the Tax Code could help ease the impact of the recession on your individual tax liability. Our office can help you plan a year-end tax strategy that incorporates many of the traditional "tried and true" strategies as well as some newer ones tied to recent legislation to help minimize your tax liability.

***Income shifting.*** The traditional year-end strategy of income shifting is still valuable this year but there is a twist. Under this strategy, you time your income and deductions so that your taxable income is about even for 2009 and 2010 so your tax bracket remains the same. If you anticipate being in a higher tax bracket for 2010, you may want to accelerate income into 2009 and defer deductions into 2010. Income can be delayed through setting up deferred compensation arrangements, postponing year-end bonuses, maximizing deductible retirement contributions, and delaying year-end billings. The twist is the uncertain future of the individual marginal income tax rates. Currently, the top two rates are 33 percent and 35 percent but they are temporary and will expire after December 31, 2010. The Obama administration has proposed reinstating the 36 percent and 39.6 percent rates for higher-income taxpayers. Congress could allow the higher rates to return after 2010 or make the higher rates retroactive to January 1, 2010. Our office will keep you posted on developments.

***AMT.*** Another planning complication is the alternative minimum tax (AMT). As you know, the AMT was intended to ensure that very wealthy individuals did not evade taxation. Because the AMT was not indexed for inflation, and for other reasons, the AMT today encroaches on many moderate-income taxpayers, especially two-income married couples. Now is an opportune time to compute if you will be subject to the AMT for 2009 or 2010. Our office can explore whether certain deductions should be more evenly divided between 2009 and 2010 and whether certain deductions will qualify, or will not be as valuable, for AMT purposes. Congress is also expected to extend to 2010 a temporary AMT "patch" that insulates many moderate-income taxpayers from the AMT.

***Gains and losses.*** Our office can also help you time the recognition of capital gains and losses to minimize net capital gains tax and maximize deductible capital losses. The process involves determining short term gains, long-term gains, short-term losses, and long-term losses, among other items, and then determining how you might vary the mix before year-end to maximize existing losses and minimize existing gains. Many investors have excess capital losses from 2008 that they may now "carry over" to offset capital gains that would otherwise be taxable. We can help you coordinate your year-end trades with these computations.

Also, you may benefit from the special 0% rate on long term capital gains and dividends. If you are in the 10% or 15% brackets, long term capital gains and dividends are tax free until you reach \$67,900 of taxable income (\$33,950 for singles). We can help you determine if you can take advantage of this exception that will disappear in future years.

***First-time homebuyer credit.*** A taxpayer who is a first-time homebuyer of a principal residence may claim a refundable credit equal to 10 percent of the purchase price of the residence (with a maximum credit of \$8,000 (\$4,000 for married couples filing separately)). The Worker, Homeownership and

Business Assistance Act of 2009, signed into law on November 6, extends the credit for qualified taxpayers purchasing principal residences on or before April 30, 2010. If a taxpayer enters into a binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010, the new law treats the credit as not expiring until July 1, 2010.

The new law also expands the credit to "long-time homeowners" who are buying replacement property but at a reduced amount of the credit. Individuals who have owned and used the same residence as their principal residence for any five consecutive year period during the eight year period ending on the date of the purchase of a subsequent principal residence may be eligible for a reduced credit of \$6,500 (\$3,250 for married couples filing separately).

Congress has also made the credit available to more individuals by increasing the modified adjusted gross income (MAGI) phaseouts for the credit. For purchases made after November 6, 2009, the credit begins to phase out for individuals with MAGI between \$125,000 and \$145,000, and for married couples filing joint returns with MAGI between \$225,000 and \$245,000.

**Green incentives.** When considering home improvements, do not forget a variety of federal tax incentives that can help you save money. One of the more popular tax breaks is the residential energy property credit. The credit is 30 percent of the sum of expenditures for qualified energy efficiency improvements, including windows, furnaces, water heaters, heat pumps, and more, which are placed in service in 2009 and 2010. The credit is limited to \$1,500 for 2009 and 2010. The improvement must meet strict energy efficiency standards. If it does not, you cannot claim a credit. This is a common error and it can be a costly one. Our office can review your planned purchase and make sure you will qualify for this valuable incentive.

The Tax Code also rewards taxpayers who purchase "green" vehicles, such as hybrid vehicles and soon to be available plug-in electric drive vehicles. As with home improvements, the vehicle must meet certain energy efficiency standards. The IRS has certified the eligibility of many hybrid vehicles for the alternative vehicle tax credit. Additionally, the alternative motor vehicle credit is now treated as a nonrefundable personal tax credit. This means that it can be used to offset regular tax liability and AMT liability the same as other nonrefundable personal credits to the extent allowed.

**Required IRA Distributions.** There are no required year end distributions from IRAs this year for individuals 70 ½ and older. Congress is not likely to extend this for 2010 withdrawals so plan on resuming these payments in 2010.

**Equipment Purchases for Business.** For 2009, a business can immediately deduct up to \$250,000 for qualifying equipment purchases, including computers and software. The property must be used more than 50 percent for business. It can be used on new property but in all cases must be your business's first use of that property. To take the deduction for 2009, qualified equipment must be placed in use by December 31, 2009. Keep in mind that any unused Code Sec. 179 amount cannot be carried over into the next year. Please contact our office if you are considering an equipment purchase or other qualifying purchase before year-end. You don't want to miss out on this valuable tax break, which is scheduled to end in 2010.

A related, and also temporary tax break, is 50 percent first-year bonus depreciation of the adjusted basis of qualifying property. The property must be (1) eligible for the modified accelerated cost recovery system (MACRS) with a depreciation period of 20 years or less; (2) water utility property; (3) computer software (off-the-shelf); or (4) qualified leasehold property. Only new property qualifies. In addition, it must be "placed in service" before January 1, 2010, with some exceptions for certain transportation property

***Sales tax deduction for new vehicles.*** You can deduct the sales tax paid on up to \$49,500 of the cost of a new vehicle purchased after February 16, 2009 and before January 1, 2010. This tax break may benefit you whether you itemize your deductions or not. This break starts phasing out for married couples with AGI's over \$250,000 and singles with AGI's over \$125,000. Furthermore, it is not likely to be extended into 2010.

***Looking ahead.*** What is on the horizon, for 2010 and beyond, is also crucial to effective year-end tax planning this year. In 2010, the opportunity to convert any IRA into a Roth IRA without the long-time \$100,000 income restriction has many individuals already setting aside funds. Some individuals, however, may do better to convert to a Roth IRA before the end of 2009, when the value of their accounts, and the consequential income that must be recognized on conversion, are at historic lows.

***Estate Tax Update.*** Congress is working quickly to pass an extension of the estate tax exemption and make it permanent at \$3.5 million per taxpayer. This legislation passed the House of Representatives on 12/3/09 and will be taken up by the Senate next. Under current law, the estate tax goes away completely in 2010 and then returns in 2011 but with a \$1,000,000 exemption. The majority in congress do not want to see 2010 arrive with a zero rate estate tax so watch for some new legislation in this area in the next few weeks. We will keep you posted.

Please contact our office if you have any questions about any of the provisions we discussed in this letter or any other questions about year-end tax planning.

Sincerely yours,

*Dino & Mark*