The Reardon Group

Newsletter

TAX TIPS

Year-EndTax Planning

The Reardon Group
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Healthcare, Financial & Management Consulting
Valuation Advisors, Inc.
Valuations for Practice Mergers & Acquisitions, Estate & Gift Taxes and Litigation Services

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To Our Clients and Friends:

2009 Year-End Tax Planning for Individuals

Year-end tax planning for 2009 presents a unique chance for you to lower your tax liability, especially in light of the significant tax law changes that were enacted in response to the struggling economy. Although traditional planning techniques remain fundamentally important considerations, new opportunities and risks provide planning variables unique to this year-end.

Managing the income that you recognize or defer in 2009 may be beneficial, but with tax reform on the horizon, balancing tax rates between 2009 and 2010 and beyond becomes more difficult. Proposed increases in income and capital gain tax rates for 2011 make the traditional year-end strategy of deferring your 2009 income into 2010 less attractive. Deferring too much income could result in excessive income in 2010, especially if you also accelerate 2011 income into 2010 to escape higher rates.

However, many of the tax breaks in recent stimulus tax bills are due to expire at the end of this year. Since it is uncertain whether Congress will extend any or all of the expiring tax incentives, taking advantage of this tax relief while it is still available should be considered. Some tax incentives that are set to expire include:

- the above-the-line deduction for teachers' classroom expenses;
- the above-the-line higher education tuition deduction;
- the additional standard deduction for real property taxes;
- the AMT exemption amount patch;
- the itemized state and local sales tax deduction;
- the moratorium on required minimum distributions (RMDs);
- the motor vehicle sales tax deduction, which applies to qualified new vehicle purchases after February 16, 2009 and before January 1, 2010;
- tax-free IRA distributions to charity;
- the nonrefundable tax credit offset of regular and AMT tax liability; and
- COBRA premium assistance for unemployed workers who are involuntarily terminated between September 1, 2008 and December 1, 2009.

In addition to those provisions that are scheduled to expire in 2009, there are others that continue to apply. A variety of popular tax exclusions, deductions and credits for individuals were provided, extended or enhanced by the American Recovery and Reinvestment Tax Act of 2009 (2009 Recovery Act), as follows:

Exclusions from Income:

- Qualified bike commuting reimbursements of up to $20 per month
- Discharged principal residence indebtedness of up to $2,000,000 ($1,000,000 for married separate filers)

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- $250 economic recovery payments
- Increased $460 per month limitation for transportation fringe benefits offered by an employer
- Exclusion of the first $2,400 (per person) of unemployment compensation benefits received
- The percentage of exclusion is increased to 75% for sales of small business stock acquired after February 17, 2009 and before January 1, 2011 (stock must be owned and held for more than five years).

Deductions:

- Safe harbor method to calculate theft loss deduction for fraudulent investment (Ponzi) schemes
- Qualified mortgage insurance premiums obtained in connection with acquisition indebtedness
- Computer equipment and technology, and internet access and related service costs are qualified higher education expenses for qualified tuition programs for 2009 and 2010.

Tax Credits:

- The American Opportunity Tax Credit replaces the Hope Scholarship Credit for 2009 and 2010, and now applies to the first four rather than the first two years of a student's post-secondary education. The maximum credit is increased to $2,500 per eligible student.
- The refundable earned income credit is increased to a maximum of $5,657 for qualifying families with three or more children.
- Beginning with purchases after December 31, 2008, the maximum first-time homebuyer credit (FTHBC) amount is increased to $8,000 ($4,000 for married separate filers). The FTHBC is extended by the Worker, Homeownership, and Business Assistance Act of 2009 (2009 Worker Act) to include qualifying purchases after April 9, 2008, and before May 1, 2010. In addition, for 2009 and 2010, the 2009 Worker Act waives the recapture of the credit if the home is used as a principal residence for at least three years.
- Certain government retirees can claim a refundable $250 tax credit ($500 on a joint return if both spouses are eligible).
- A refundable Making Work Pay Credit (MWPC) is advanced to eligible workers, generally through reduced income tax withholding. The MWPC is equal to the lesser of 6.2 percent of earned income, or $400 ($800 for married joint filers).
- The refundable portion of the child tax credit (CTC) is increased to 15% of earned income in excess of $3,000 (the previous threshold amount was $12,550, making the maximum increase in the refundable CTC $1,432.50).
- The credit for nonbusiness energy property (CNEP) is extended through 2010, and the credit amount increases from 10 to 30 percent of qualified energy efficiency improvements (including doors, windows, furnaces, central air conditioners, water heaters, heat pumps, biomass stoves, and certain asphalt roofs). The credit is limited to a total of $1,500 over the 2009 and 2010 tax years.
- The residential energy efficient property (REEP) annual credit maximums of $2,000 for solar hot water heaters, $500 for each half kilowatt of electric capacity generated by a wind turbine (not to exceed $4,000 annually), and $2,000 for geothermal heat pumps are eliminated for tax years 2009 through

2016. The maximum annual credit for each half kilowatt of electric capacity from fuel cell plants remains at $500.

- For tax years beginning in 2009, the alternative motor vehicle (AMV) credit is treated as a nonrefundable personal tax credit.
- A credit is available for qualified plug-in electric drive motor vehicles (PEDMVs) placed in service in 2009 through 2014. The maximum PEDMV credit is between $7,500 and $15,000 depending upon the weight of the vehicle.
- A new credit is available for converting an existing motor vehicle into a qualified PEDMV. The maximum credit of $4,000 applies to conversions made after February 17, 2009 and before December 31, 2011.
- The new plug-in electric vehicle credit (PEVC) is modeled on the PEDMV credit, and provides a credit equal to 10% of the cost of acquiring certain electrically powered 2-wheeled, 3-wheeled, and low-speed vehicles. The PEVC is capped at $2,500, and generally applies to vehicles purchased after February 17, 2009 and before January 1, 2012.

Ideas for Investments

Harvest Capital Losses. If you are sitting on some investments that have dropped in value since you acquired them, now might be a good time to dump part or all of them to cut your tax bill. You can deduct capital losses up to the amount of any capital gains that you'll have for the year (for example, from mutual fund distributions or sales of stocks or bonds). Also, you can claim up to an additional $3,000 of losses ($1,500 if you're married but filing a separate return) against your other income. Any losses in excess of these amounts carry over to next year.

If you're selling less than your entire interest in an investment, you can maximize the amount of deductible loss that you realize by telling your broker or mutual fund company to sell the highest basis shares first (and then have them confirm your instructions in writing within a reasonable time after the sale). In addition, if you think your investments that are currently underwater are poised for a comeback, you can buy them back after taking a loss as long as you don't reacquire them within 30 days before *or* after the sale.

Take Advantage of 0% Capital Gains Rate before It Is Too Late. For 2009, the federal income tax rate on long-term capital gains and qualified dividends is 0% when they fall within the 10% or 15% regular federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed $67,900 if you're married and file jointly ($33,950 if you're single). This 0% rate will likely continue to apply in 2010, but is scheduled for repeal in 2011.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who can. If so, consider giving them some appreciated stock or mutual fund shares, which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period is over a year. Giving away stocks that pay dividends is another tax-smart idea. As long as the gift recipient is in the 0% or 15% regular tax rate bracket, the dividends will be federal-income-tax-free.

Watch out though, if during 2009 you give away assets worth over $13,000 to an individual gift recipient, the excess will generally eat into your $1 million lifetime federal gift tax exemption and your $3.5 million federal estate tax exemption. However, you and your spouse can together give away up to $26,000 per recipient without any adverse effects on your respective gift and estate tax exemptions. Also, if you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting investment income to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions.

Secure a Deduction for Nearly Worthless Securities. If the dismal economy has left you with securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier to just sell the security if it has any marketable value. As long as the sale is not to a close family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

Purchase a Qualifying Hybrid or Lean Burn Technology Vehicle. If you have been considering purchasing a new hybrid or lean-burn technology vehicle, now may be a good time to do so. First of all, as we discussed earlier, the sales tax paid on the vehicle may be deductible. Secondly, purchasing a qualifying new (not used) vehicle this year may reap you an alternative motor vehicle tax credit from around $900 to $3,000, depending on the vehicle, which in 2009 can offset the AMT. However, not all 2009 purchases qualify as credits are phased out once the manufacturer has sold over 60,000 qualifying vehicles. Because of this rule, no credits are allowed for 2009 purchases of Toyota, Lexus, and Honda hybrids and only reduced credits are available for Ford and Mercury hybrids. So far, full credits are still allowed for hybrids made by Chrysler, GM, Mazda, and Nissan. Full credits are also allowed for lean-burn technology vehicles made by Mercedes, Volkswagen, BMW, and Audi. Give us a call if you want to know the available credit amount for a specific hybrid or lean-burn technology vehicle.

Ideas for Seniors Age 70½ or Older

Make Charitable Donations Directly from Your IRAs. If you've reached age 70½, you can arrange to transfer up to $100,000 of otherwise taxable IRA money to the public charity of your choice (such as your church or other favorite charity). The distribution is federally income tax free. You don't get to claim it as an itemized deduction on your Form 1040. However, the tax-free treatment equates to a 100% write-off, and you don't have to itemize your deductions to get it. Additionally, since it is tax-free, it may reduce your Social Security benefits subject to tax. Be careful though—to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity (you can't receive cash and then donate it). Also, this provision expires at the end of 2009 unless Congress extends it. So, this could be your last chance.

Don't Take Your Minimum Required Distribution for 2009. The tax laws generally require individuals with retirement accounts to take withdrawals based on the size of their account and their age every year after they reach age 70½. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. However, a temporary tax law change made in late 2008, waives the minimum distribution requirement for 2009. This means you can leave the amounts in your account without suffering the 50% penalty. This waiver applies to IRAs and defined-contribution plans, including distributions from 401(k), 403(b), and state-sponsored 457(b) accounts and is available to everyone regardless of their total retirement account balances.

Bottom Line: If you haven't already received your required distribution during 2009 and you do not need the funds, you can just leave them in your retirement account for another year.

Ideas for Your Estate

The federal estate tax exemption for 2009 is $3.5 million. For 2010, the federal estate tax is supposed to be repealed—but just for that one year. It now seems clear that if the promised repeal ever happens at all, it will just be for 2010. The more likely scenario is that we will continue to have a federal estate tax for 2010 and beyond with a $3.5 million or somewhat larger exemption. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan.

Make Annual Gifts to Reduce Your Estate. Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you and your spouse both can give each of them up to $13,000 this year. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So, the sooner you start an annual gifting program, the better.

Capitalize on Depressed Security Values to Boost Giving Power. The current depressed security values may mean that more assets can be transferred within the limits of the gift tax annual exclusion amount ($13,000 for 2009) and the lifetime applicable exclusion amount ($1 million). Thus, if a security's value is expected to participate in the inevitable (we hope) economic recovery (and especially if the security is expected to significantly appreciate) this may be the perfect time to give the security to the intended recipients. However, d*o not* give away loser shares (currently worth less than what you paid for them). Instead, sell the shares, and take advantage of the resulting capital loss, and then give away the cash.

2009 Year-End Tax Planning for Businesses & Professionals

Business tax planning for year-end 2009 presents new opportunities and new challenges for business taxpayers to reduce or defer federal income tax liability. Although traditional planning techniques remain fundamentally important considerations this year, there are new opportunities with recent legislation and changes in the tax laws. In addition, tax planning is complicated with the anticipation of tax laws that may be put to a vote in Congress before year's end and the unknown status of those provisions that are scheduled to expire this year.

The bonus depreciation deduction, increased section 179 dollar and investment limitation, and the election to accelerate credits in lieu of bonus depreciation are a few tax incentives that expire during the remainder of 2009 and require action by you in the coming months in order to take advantage of them.

Bonus Depreciation and Code Sec. 179 Expensing

As a trade or business, you have the option of depreciating an additional 50 percent of the cost of an asset in the first year if it is acquired and placed in service through 2009. The types of property eligible for bonus depreciation include tangible property with a recovery period of 20 years or less, purchased computer software, water utility property and qualified leasehold improvement property.

For bonus depreciation purposes, the regular dollar cap for new vehicles placed in service in 2009 is raised by $8,000 if bonus depreciation is claimed. For example, the dollar cap for passenger vehicles placed in service in 2009 is $10,960 if bonus depreciation is claimed and $2,960 if it is not claimed. Similarly, the depreciation cap for trucks and vans placed in service in 2009 is $11,060 if bonus depreciation is claimed and $3,060 if it is not claimed.

In lieu of claiming any bonus depreciation, you are allowed to claim any accumulated AMT and research credits. However, like bonus depreciation, the election only applies to property that is placed in service through 2009.

Alternatively, Code Sec. 179 allows you an election to expense, rather than capitalize and depreciate, assets placed in service. This expensing deduction has been temporarily increased to $250,000, with a phase-out investment amount of $800,000, for qualifying property placed in service for tax years beginning in 2008 or 2009. This extension may enable you to write off more equipment purchased in 2009 for use in your trade or business. For example, a calendar-year taxpayer has until December 31, 2009, to place property in service in order for it to be eligible for the Code Sec. 179 deduction.

Research Credit for Increasing Research Activities

The research credit was provided to encourage taxpayers to increase their research expenditures. This credit was extended to apply to amounts paid or incurred before December 31, 2009. In addition, effective for tax years ending after December 31, 2008, the rates to compute the credit using the alternative simplified method are increased, and a taxpayer's election to use the alternative incremental method for qualified research expense is terminated.

Federally Declared Disaster Relief for Businesses

Taxpayers affected by a federally declared disaster before January 1, 2010 may benefit from a special five-year carry-back period for net operating losses attributable to the disaster; a deduction for qualified disaster expenses; an additional depreciation allowance; and increased deduction and limitation amounts under Code Sec. 179.

Other provisions that may offer opportunities that should be evaluated as part of your year-end tax planning include:

- Deferral of discharge of indebtedness income resulting from reacquisition of business debt. At the election of the taxpayer, income from the discharge of debt in connection with the reacquisition before January 1, 2011, of business debt instrument is includable in gross income ratably over a five tax years.
- Work Opportunity Tax Credit. The work opportunity tax credit was designed to provide an incentive for employers to hire individuals from disadvantaged groups that have a particularly high unemployment rate. The credit is equal to 40% of the first $6,000 of wages paid to the individual during the first year of employment.
- Reduced recognition period for S corporation built-in gains tax. For tax years beginning in 2009 and 2010, no tax is imposed on an S corporation's net unrecognized built-in gains if the seventh tax year in the corporation's 10-year recognition period preceded its 2009 or 2010 tax year.
- Book inventory contributions. For C corporations only, an enhanced deduction for donations of book inventory is allowed when made to public schools, or a qualified charity or private operating foundation for use in the care of the ill, the needy or infants before January 1, 2010.
- 15-year MACRS recovery period for restaurant improvements and buildings. The 15-year recovery period for improvements to a restaurant building is extended to apply to restaurant buildings placed in service in 2009.
- Energy efficient commercial buildings deduction. A deduction is available for certain energy efficiency improvements installed before January 1, 2014 on, or in, a depreciable building located in the United States. This deduction applies to property installed as part of a building's interior lighting systems; heating, cooling, ventilation, and hot water systems; or envelope, as part of a plan to reduce total energy and power costs of the system as least 50 percent. The deduction is limited to $1.80 times the total square footage of the building.

- Alternative minimum tax. The alternative minimum tax (AMT) is not a challenge reserved solely for individual taxpayers. A corporation that is not a "small corporation" may be required to pay AMT if the corporation claims tax preference items or certain credits.
- Extended Net Operating Loss Carryback Period. The Worker, Homeownership, and Business Assistance Act of 2009 allows businesses of all sizes to elect to carryback a net operating loss to more than two and less than six years for 2008 and 2009, subject to limitations.

Sole proprietors, partners, LLC members and S corporation shareholders have additional unique tax planning considerations because business planning opportunities must be viewed in conjunction with personal tax planning.

For example, estimated tax payments of qualified individuals for tax years beginning in 2009 may be based on 90 percent of the individual's prior year's tax liability. An individual is a qualified individual if their adjusted gross income shown on the individual's return for the preceding tax year is less than $500,000 and more than 50 percent of the gross income shown on the return for the preceding tax year is from a business which employed less than 500 employees on average.

In addition, small employers and the self-employed may benefit from a review of the independent contractor vs. employee classification because it affects both the worker and the employer. A worker's classification determines who is liable for employment taxes. Misclassification can have serious tax consequences.

Overall, a key element of tax planning is a careful review of these incentives and provisions, and how best to take advantage of them in the current tax year. However, there have been proposals to increase the income and capital gains tax on single individuals with income of more than $200,000, and married couples with income exceeding $250,000. Therefore, following the traditional year-end planning maxim of deferring income into next year may not be a positive strategy. Deferring too much income into 2010 could result in income taxed at a higher rate.

Ideas for the Office

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has an FSA, before year-end you must specify how much of your 2010 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying child care costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts—you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

Adjust Your Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2009, consider bumping up the Federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will still have to pay any taxes due less the amount paid in. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your estimated 2009 liability or, if smaller, 100% of your 2008 liability (110% if your 2008 adjusted gross income exceeded $150,000; $75,000 for married individuals who filed separate returns), interest and penalties will be minimized, if not eliminated.

Watch out for States that elect out of certain areas of these provisions

Regardless of your tax entity, your state's treatment of these and many other provisions may be a more significant issue this year than in prior years. Although a state may wish to boost its economy by adopting some of the 2009 Recovery Act provisions, they cannot afford to create deeper revenue shortfalls. Therefore, what may be treated as a deduction for federal purposes may be an adjustment to income as computed by the state. This is especially true regarding a state's treatment of bonus depreciation and the increased section 179 deduction, which also impacts a decision to accelerate AMT and investment credits. These are often referred to as "State Decoupling Adjustments". Delaware, Maryland, New Jersey and Pennsylvania each have adopted varying forms of decoupling adjustments,

Business tax planning involves not only planning for the current year, but also making wise tax decisions that will benefit your business for years to come. A further review of your options now could identify what you can do over the next month to save money on your 2009 tax bill and plan for the future.

Conclusion

With the year drawing to a close, now is an ideal time to review your tax situation and evaluate strategies that may help minimize your tax bill. Hopefully, this letter provides some alternatives that you would like to consider before year-end. Please accept our best wishes for a successful and less taxing New Year!

Best regards,

Weiss + Reardon & Company, P.C.

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