

To My Clients and Friends:

As we approach year-end, it's again time to focus on last-minute moves you can make to save taxes—both on your 2009 return and in future years. The federal income tax environment is very favorable right now, but it is not likely to continue much longer. Now is the time to take advantage of the tax breaks that Congress has provided before they disappear.

Some General Comments before We Get Started...

First of all, the goal of year-end tax planning is to identify strategies that will allow you to pay the lowest overall tax. One means of accomplishing this if you expect your income to stay about the same during the next few years, is to postpone when taxable income must be reported and accelerate the time when expenses can be claimed as deductions. Another is to trade taxable investment income for nontaxable revenue such as municipal bond interest. (However, this second strategy only makes sense if the tax-free yield on the new investment is greater than the after-tax rate on the old one.) Still another smart move for many people is to convert ordinary income (taxed at rates up to 35%) into long-term capital gains that are subject to a tax rate of no greater than 15%.

Regardless of the approach taken, however, it's important to limit tax planning to achieving your financial goals in a tax efficient manner. In addition, you should look at your tax situation for at least a two-year period, with the objective of reducing your tax liability for the two years combined rather than just for 2009.

Watch out for AMT. It is also important to be on the alert for the alternative minimum tax (AMT). Individuals must compute their income taxes under two systems—the regular tax system and the AMT system—and pay the higher of the two amounts. When introduced many years ago, the AMT targeted and normally only applied to high-income taxpayers who, in Congress' opinion, benefited too much from certain tax breaks. Today, however, virtually no taxpayer can ignore the AMT. Therefore, the first step in tax planning is to assess your exposure to AMT. Tax planning for AMT is often dramatically different than planning for regular tax. In fact, it's sometimes backwards.

Who is at the highest risk for AMT? Many taxpayers can fall into AMT, but those who deduct a significant amount of state and local taxes or miscellaneous itemized deductions (like unreimbursed employee business expenses) or claim multiple dependents are especially vulnerable. Those who recognize a large capital gain or exercise incentive stock options during the year are also vulnerable. If you suspect AMT might be an issue, please contact me so we can plan accordingly.

With these general principles in mind, let's take a look at some specific tax planning ideas that apply to the vast majority of taxpayers—that is, those in a regular tax situation. Call me if you would like to discuss those that may be appropriate for you or if you want to consider other tax-saving strategies.

Ideas for Increasing Deductions

One way to reduce your 2009 tax liability is to look for additional deductions. Here's a list of suggestions to get you started:

Make Charitable Gifts of Appreciated Stock. If you have appreciated stock that you've held more than a year and you plan to make significant charitable contributions

before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no load mutual funds because there are no transaction fees involved.)

However, if the stock is now worth less than when you acquired it, sell the stock, take the loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value and no capital loss will be available. Also, if you sell the stock at a loss, you can't immediately buy it back as this will trigger the wash sale rules, which means your loss won't be deductible, but instead will be added to the basis in the new shares.

Maximize the Benefit of the Standard Deduction. For 2009, the standard deduction is \$11,400 for married taxpayers filing joint returns. For single taxpayers, the amount is \$5,700. Currently, it looks like these amounts will be about the same for 2010. If your total itemized deductions are normally close to these amounts, you may be able to leverage the benefit of your deductions by bunching deductions in every other year. This allows you to time your itemized deductions so that they are high in one year and low in the next. You claim actual expenses in the year they are bunched and take the standard deduction in the intervening years.

For instance, you might consider moving charitable donations you normally would make in early 2010 to the end of 2009. If you're temporarily short on cash, charge the contribution to a credit card—it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or state income taxes otherwise due in early 2010. But, watch out for the AMT, as these taxes are not deductible for AMT purposes.

Bunch Deductions Subject to an Adjusted Gross Income Limit. Miscellaneous itemized deductions (such as unreimbursed employee business expenses) are deductible to the extent they exceed 2% of your adjusted gross income (AGI). (Your AGI is the number at the bottom of the first page of your return.) Medical expenses are deductible only to the extent they exceed 7.5% of AGI. To lessen the affect of these AGI limitations, try to bunch your miscellaneous and medical expense deductions into every other year.

Purchase Certain Big Ticket Items in 2009. Thanks to a couple of expiring temporary tax breaks, it may pay to purchase certain big-ticket items before the end of the year:

- The optional itemized deduction for state and local sales and use taxes (in lieu of deducting state income taxes) will expire at the end of this year unless Congress takes further action. Therefore, if you live in a state with low or no state income tax and plan on making big-ticket purchases (such as a car, boat, or motorcycle, or airplane) in the near future, you may want to go ahead and make the purchase this year to cash in on the expiring sales tax break for 2009. There is no AGI based limit for this deduction, but you have to itemize to benefit and it is not allowed for AMT.
- If you live in a state with high state income taxes and plan on deducting state income taxes instead of state sales taxes this year, legislation passed earlier this year created a one-year federal income tax deduction that might interest you. For 2009, you can deduct state and local sales and excise taxes on purchases of new (not used) passenger autos, pickups, and SUVs, as well as motorcycles and RVs made between 2/17/09 and 12/31/09. The write-off is limited to the amount of taxes on the first \$49,500 of purchase price. You can claim the break whether you

itemize or not, and it is allowed even if you owe the AMT. However, a phase-out rule can reduce or completely eliminate the break if your AGI exceeds \$250,000 (\$125,000 if you are single).

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 me 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).

Ideas for Your Business

Consider Paying a Dividend in 2009. If you're a shareholder in a closely held C corporation, the current federal income tax rate structure is helpful to your cause. If the company pays you a taxable dividend, the maximum federal rate is only 15%. Better yet, as discussed earlier, if the stockholder's (you or perhaps a child to whom you've given stock) taxable income is low enough there won't be any tax at all on this income assuming Kiddie Tax doesn't come into play. However, this may well change in the near future. Thus, now may be a good time to convert some of your C corporation wealth into cash at a very manageable tax cost (and possibly none at all). The maximum federal rate on dividends is scheduled to skyrocket from the current 15% to 39.6% starting with 2011.

Take Advantage of Temporary Tax Breaks for Equipment and Software Purchases . If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property, you might consider doing so before year-end to maximize your 2009 deductions. Here's why:

- *Bigger Section 179 Deduction.* Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2009, the maximum Section 179 deduction is a whopping \$250,000. However, the allowable deduction is reduced dollar-for-dollar to the extent the amount of qualifying property placed in service during the year exceeds \$800,000. For tax years beginning in 2010, the maximum deduction is estimated to drop back to about \$134,000, with reductions estimated to begin when more than \$530,000 of qualifying property is placed in service.
- *50% First-year Bonus Depreciation.* Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost (reduced by the Section 179 deduction) of most new (not used) equipment and software acquired and placed in service by December 31 of this year. The 50% first-year bonus depreciation break will expire at year-end unless Congress takes further action.

Avoid the Hobby Loss Rules. A lot of businesses that are just starting out or have hit a bump in the road thanks to the dismal economy may wind up showing a loss for the year. The last thing the business owner wants in this situation is for the IRS to come knocking on the door arguing the business's losses aren't deductible because the activity is just a hobby for the owner. Surprisingly, the IRS has been fairly successful recently in making this argument when it takes taxpayers to court. Thus, if your business is expecting a loss this year, we should talk before year-end to make sure we do everything possible to maximize the tax benefit of the loss and minimize its economic impact.

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.

Ideas for Seniors Age 70 1/2 or Older

Make Charitable Donations Directly from Your IRAs . If you've reached age 70 1/2, 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 70 1/2. 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. If you have already received the distribution and now wish you hadn't, you may be able to roll the funds back into your retirement account, even if the normal 60-day rollover period has already expired. However, this may require action before 11/30/09. If this situation applies to you, please give me a call.

Environmentally Friendly Ideas

Make Energy Efficiency Improvements to Your Home. A great way to cut energy costs and save up to \$1,500 in federal income taxes this year is to make energy

efficiency improvements to your principal residence. Basically, if you install energy efficient insulation, windows, doors, roofs, heat pumps, hot water heaters or boilers, or advanced main air circulating fans to your home during 2009 or 2010, you may be entitled to a tax credit of 30% of the purchase price, up to a maximum credit of \$1,500. For 2009, the credit is allowed against the AMT. However, unless Congress changes the rules, this will not be the case for 2010. If there is any possibility you'll be subject to AMT next year, you may want to make these improvements this year.

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 I mentioned 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 me a call if you want to know the available credit amount for a specific hybrid or lean-burn technology vehicle.

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, do 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.

Conclusion

With a little effort and some careful planning, it's possible your 2009 tax liability can still be significantly reduced. I am available to assist you in this planning process any way I can. Please don't hesitate to contact me with questions or ideas on reducing your tax bill.