

2009 MID-YEAR TAX PLANNING NEWSLETTER

Summer is here, and most people would rather be planning their vacations than planning their taxes. Taxes have become increasingly complicated. And while opportunities remain for year-end tax planning, this letter is focused more on steps that are difficult to take at the last minute. You will have to get started now if you want to implement many of the suggestions on the following pages in time to affect your 2009 taxes.

Congress continues to use the federal tax law to raise revenue, stimulate the economy, reform healthcare, create jobs and save the planet. Sometimes it seems that Congress sees the solution to every problem as a modification to the federal tax law.

As the economy struggles to recover from a severe, worldwide recession, Congress must carefully balance both tax increases and decreases along with the federal budget. To maintain this delicate balance, in the past several years Congress has passed tax changes that phase in, phase out or sunset. Legislators apply some laws retroactively, while they've given others a delayed effective date.

In this ever-changing environment, it is challenging to stay informed, understand the changes and effectively incorporate those changes into a comprehensive, cohesive tax plan. Yogi Berra was right, "The future ain't what it used to be."

To confound matters even more, President Obama has appointed a panel to review the tax code to close loopholes, streamline the law and generate revenue. As the press covers the panel's recommendations, keep in mind that President Bush appointed a national commission to consider tax reform in 2005. After 10 months of effort, that group's unanimous recommendation to scrap or restructure many popular deductions drew immediate bipartisan opposition. Neither the president nor Congress ever acted on those recommendations.

Also keep in mind, however, that by all indications President Obama does not intend to extend the tax cuts enacted during the Bush administration. As such, by 2011 you should expect to see an increase in both the highest marginal tax rate on ordinary income to 39.6 percent and the tax rate on dividends and long-term capital gains to 20 percent.

Reading this newsletter is a start toward planning moves that will assist you in achieving your tax and financial goals. If you have questions about anything in this letter – or even what's not in this letter – please call! We are committed to working with you to identify the tax strategies that meet your unique needs.



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INVESTMENT & RETIREMENT STRATEGIES

Funding your retirement plans – Contributing to a tax-qualified retirement plan can reduce your current tax obligations and help you save for your retirement in a tax-efficient manner. To qualify for a tax deduction in 2009, your retirement plan generally must be in place before the end of the year. Exceptions are IRA and SEP (simplified employee pension) plans, which must be set up by April 15, 2010. Establishing a new retirement plan for you and your employees requires thoughtful decision-making. You will want to plan accordingly and not develop it too hastily.

Contributions also provide tax deferral on earnings until distributions are made. So the sooner you make the contribution, the sooner your tax-deferred earnings begin. If you already have a plan in place, consider funding it as soon as possible rather than waiting until the last minute.

IRAs and Roth accounts – Everyone with earned income, including alimony, is eligible to contribute to a traditional IRA. If you are not covered by an employer-sponsored retirement plan, you may also have the choice of deducting your contribution to your traditional IRA. At higher income levels, modified adjusted gross income above \$65,000 for singles and \$109,000 for joint filers, no deduction is allowed.

Many people find the long-term benefits of contributing to a Roth IRA or a Roth 401(k) outweigh the short-term financial benefits of tax-deductible contributions. While Roth contributions are not tax-deductible unless there are early distributions, none of the income earned in the Roth account will ever be subject to income tax. In addition, the Roth account is not subject to the required minimum distribution rules that apply when you reach age 70½.

Eligibility to contribute to a Roth IRA depends on the amount of your income. No contribution is allowed if your modified adjusted gross income for 2009 exceeds \$120,000 for singles and \$176,000 for joint filers. You can make a direct rollover from your traditional IRA or other qualified retirement plan into a Roth IRA. However, you must pay tax on the rollover amount. During 2009, you cannot execute a Roth rollover if your adjusted gross income exceeds \$100,000. But beginning Jan. 1, 2010, anyone – regardless of adjusted gross income – can execute a rollover. For a rollover during 2010, your tax is delayed and paid in equally in 2011 and 2012.

The provision allowing those over age 70½ to make tax-free distributions of up to \$100,000 from IRAs to charities is set to expire at the end of 2009. Although you receive no charitable contribution deduction, the distribution is not included in your income. The effect is to bypass the limits on itemized deductions and may even produce a state income tax benefit in states that use federal adjusted gross income as their tax base.

The following limits apply for the 2009 tax year:

- Participants in a 401(k) plan can defer up to \$16,500 (\$22,000 for ages 50 or older).
- The IRA contribution limit is \$5,000 (\$6,000 for ages 50 and older).
- Simple IRA participants can defer up to \$11,500 (\$14,000 for ages 50 and older).
- Self-employed individuals can contribute 20 percent of their self-employment income up to \$49,000.

Tax rate of 0 percent on capital gains and dividends – The maximum rate of tax on qualified dividends and most long-term capital gains is 15 percent. For those whose marginal tax rate does not exceed 15 percent, the tax rate on these special types of income is reduced to 0. If you are single and your taxable income for 2009 is under \$33,951, or you are married with taxable income under \$67,901, the 0 percent rate applies to you.

Many people with taxable income below these thresholds do not experience the types of income that qualify for the 0 percent rate. And the kiddie tax rules (see next section) prevent your children from qualifying also. However, if you assist aging parents, you might consider gifting appreciated stock to them if they are in the 10 or 15 percent tax brackets. They could then sell the investment and qualify for the 0 percent tax rate on the gain.

Kiddie tax rules – For 2009, all children under age 19 and dependent college students under age 24 will have their unearned income in excess of \$1,800 taxed at their parents' marginal tax rate. Unearned income includes interest, dividends and capital gains.

Shifting investments to a child's account was once a popular college savings strategy, especially when the child was in a lower tax bracket. Now, a good alternative may be investing in a Section 529 college savings plan, where funds grow tax-free, and subsequent withdrawals are tax-free for qualified secondary education expenses.

Wash sales – If you sell securities at a loss, the wash sale rules disallow the loss if you purchase substantially identical securities with 30 days before or after the loss sale. Do not rely on your broker to alert you to the wash sale rules. Purchases in one account can wipe out losses that you incur in a different account.

BUSINESS TAX STRATEGIES

Retirement plans for your business – Starting a small business retirement savings plan can be easier than many business people think. What's more, a retirement plan has significant tax advantages: Employer contributions are deductible from the employer's income, employee contributions are not taxed until distributed to the employee, and investments in the program grow tax-deferred. Further, the tax law offers a small incentive of a \$500-per-year tax credit for the first three years of a new SEP, Simple or other retirement plan to cover the initial setup expenses.

Depreciation – The American Recovery and Reinvestment Act of 2009 extended the expensing and depreciation incentives contained in the Economic Stimulus Act of 2008.

Section 179 – Congress extended the \$250,000 expensing election limit to qualifying property purchased and placed in service during 2009. As a result, many businesses will receive an immediate tax write-off for the cost of most new and used tangible personal property. If you do not act this year, the limit is reduced by almost one-half in 2010.

The deductible amount may be limited for some larger businesses, however. Companies that purchase more than \$800,000 of qualifying property during 2009 have their deduction amount reduced, dollar-for-dollar, for purchases in excess of \$800,000. So the deduction is not available to those companies that purchase and place in service more than \$1.05 million of qualifying property during 2009.

Businesses that use a fiscal year as their tax accounting year should note that the new deduction limit applies to property purchased and placed in service during tax years beginning in 2008 and 2009.

Bonus depreciation extended through 2009 – Property that does not qualify for an immediate tax write-off under the expensing election may qualify for an increased first-year depreciation deduction under bonus depreciation rules, which were also extended for one year by the 2009 tax act. This deduction is equal to 50 percent of the cost of qualifying property purchased and placed in service during 2008 and 2009.

To qualify for bonus depreciation, the property must be new. Used property does not qualify. In addition, the property must either:

- Have an applicable MACRS recovery period of 20 years or less
- Be water utility property or computer software not covered by the Section 197 amortization rules
- Be qualified leasehold improvement property

Businesses that use a fiscal year as their tax accounting year should note that the bonus depreciation rules apply to property purchased and placed in service before Jan. 1, 2010.

No enhanced deductions for buildings and other structures – Buildings and other real estate generally do not qualify for bonus depreciation or the expensing election. However, a cost segregation study may be able to identify qualifying property within the overall project.



BUSINESS TAX STRATEGIES (CONTINUED)

Losses from pass-through entities – Economic pressures are causing many historically profitable businesses to experience operating losses. If you are an owner of a pass-through business entity operating as a partnership, LLC, S corporation or trust, and the business incurs a loss in 2009, you need to plan ahead to be sure you can take advantage of that loss on your personal tax return.

Passive activities – If your business activity is “passive” – generally a rental real estate activity or a business in which you do not materially participate – you may not be able to deduct the loss unless you also experience passive income. For example, a loss from a partnership in which you are a limited partner would be considered a passive activity loss because limited partners are generally not actively involved in the partnership. A nondeductible passive loss is carried forward to future years until fully offset against passive income or until you dispose of your business interest. If you have a substantial passive activity loss, you may wish to consider either disposing of the business interest or acquiring an investment in a passive activity with income.

Basis limitations – Even if you are actively involved in the business, your loss may not be deductible if you do not have “basis.” These rules are complicated, and you should consult with your tax professional. But if you can take steps prior to the end of the tax year to invest more in the business or otherwise increase your basis, you may be able to deduct the loss on your return.

Lower estimated tax payments for 2009 – For businesses that operate as sole proprietorships, LLCs, partnerships or S corporations, the 2009 tax act reduces the 2009 estimated tax payment requirements for many small business owners. You will generally qualify for the reduced payments if your adjusted gross income for 2008 was less than \$500,000 and if more than 50 percent of your 2009 gross income is generated from a “small business,” which is defined as a business that, on average, had fewer than 500 employees during 2008.

Normally, you would have to pay the lower of 90 percent of your 2009 tax or 100 percent of your 2008 tax (110 percent of your 2008 tax if your adjusted gross income for 2008 exceeded \$150,000) in estimated taxes for 2009 to avoid underpayment penalties. The new tax law permits small business owners to reduce their 2009 estimated payments to 90 percent of your 2008 tax.

This rule improves your cash flow, but it does not save taxes. You will still owe your unpaid taxes when you file your 2009 return.

Work opportunity credit expanded for 2009 and 2010 – As the economy begins to recover and your business starts to add employees, a tax credit is available equal to 40 percent of the first \$6,000 of wages paid to employees in certain target groups. If your business is thinking of hiring returning veterans, you should note that the new law expands the credit-eligible target groups to include unemployed veterans and disconnected youth. Other credit-eligible groups include disabled veterans, ex-felons and food stamp recipients. This expanded benefit applies to such workers hired in 2009 and 2010. To obtain the credit, you may need to have new employees pre-qualified by your state labor department within their first 28 days of employment. If you hired unemployed veterans or disconnected youth before July 17, 2009, you have until Aug. 17, 2009, to get them certified.

State credits – Many states have income tax incentives for investing in new or existing facilities in either property or employees. If you plan to make a substantial investment in plant or people, you should discuss these ideas with your tax professional or contact the state’s revenue department to determine if tax benefits are available. The state tax benefits may be the difference in making a decision to invest in your facility. In many instances, applications must be made before the investment, so you need to plan ahead.

Business succession planning – Summer is a great time to review or implement your business plan and your succession plan. At its most basic, a succession plan is a documented road map for partners, heirs and successors to follow in the event of your death, disability or retirement. Many business owners put a great deal of effort into their business plan but give little thought to their exit strategy.

PERSONAL INCOME TAX STRATEGIES

- ✓ **Making work pay** – Last year the government was mailing out stimulus checks. This year, it's offering the Making Work Pay tax credit. For 2009 and 2010, the Making Work Pay tax credit will provide certain workers with a credit of up to \$400, or \$800 on a joint return. For individuals with earned income below \$6,452 (\$12,904 for married couples), the maximum credit is 6.2 percent of earned income. To qualify for the full credit, your modified adjusted gross income must not exceed \$75,000 for singles or \$150,000 for joint filers. Above those incomes, the credit begins to reduce. If your modified adjusted gross income exceeds \$95,000 for singles or \$190,000 for joint filers, there is no credit available.

Earlier in the year, the IRS issued new withholding tables reducing workers' withholding taxes by the maximum available credit. The objective of the lower withholding is to give workers more spending money in their take-home pay. If you do not qualify for the Making Work Pay tax credit, it is possible that your taxes will be under-withheld and you will have to pay more when you file your 2009 return. You can ask your employer to increase your withholding by completing a new form W-4.

- ✓ **Sales tax deduction for new car purchase** – In an effort to stimulate new car sales, Congress has authorized an income tax deduction for state and local sales or excise taxes. To qualify for the deduction, you must purchase a new vehicle between Feb. 17 and Dec. 31, 2009.

Importantly, the deduction is available even if you don't itemize. That means the deduction also reduces your adjusted gross income for purposes of determining whether you qualify for other tax breaks.

If your new vehicle is very expensive, the deduction is limited to the portion of the tax attributable to the first \$49,500 of the purchase price. To qualify for the full deduction, your modified adjusted gross income cannot exceed \$125,000 for individuals or \$250,000 for married couples. No deduction is available if

your modified adjusted gross income is greater than \$135,000 for individuals or \$260,000 on a joint return. Various states have different car sales taxes, so the deduction will vary depending on where you live. For example, the average new car purchase price during the first 11 months of last year was \$28,280, and the average used car trade-in value was \$15,203, according to the National Automobile Dealers Association. States typically tax the difference – \$13,077 in this case. A 5 percent sales tax rate would result in a reduction of taxable income by \$654.

- ✓ **First time home buyer credit** – This credit, which was introduced in late 2008, is increased from \$7,500 to \$8,000 for home purchases between Jan. 1 and Nov. 30, 2009. Unlike last year's credit, the \$8,000 credit does not have to be repaid if the buyer keeps the home for at least three years. For homes costing less than \$80,000, the maximum credit is 10 percent of the purchase price of the home. A first-time home buyer is someone who has not owned a home during the prior three years.

To qualify for the full credit, your modified adjusted gross income must be less than \$75,000 for singles or \$150,000 for joint filers. If your modified adjusted gross income exceeds \$95,000 for singles or \$170,000 for joint filers, there is no credit available.

- ✓ **Alternative Minimum Tax (AMT)** – The insidious AMT remains a thorn in the side of every tax planner. Although you may not clearly understand it, you probably have heard of – or experienced – its dreaded traps. This tax, initially created to ensure high-income taxpayers pay their fair share, has now expanded to encompass middle-income taxpayers. As an alternative tax system, the AMT can negate any number of tax planning steps designed to reduce the regular income tax.

There is no easy way to estimate the impact of the AMT. If you have paid AMT in the past, or you think the AMT might impact you, it's a good idea to have an experienced tax professional check your tax planning calculations.

ESTATE & GIFT TAX PLANNING STRATEGIES

Estate planning – Time is getting short for Congress to deal with the federal estate tax. The estate tax exemption amount for 2009 is \$3.5 million. The estate tax is scheduled to disappear for 2010 and reappear in 2011 with a \$1 million exemption. While Congress continues to do nothing, it is important that your estate plans remain flexible. Make sure your will distributes your assets in the appropriate manner. If you have younger children, your will should appoint a guardian in the event of the death of both parents. You certainly do not want the probate court making decisions on your behalf.

With states looking for additional revenue to balance their budgets, state inheritance taxes are getting increased attention. Be sure your estate plan minimizes inheritance taxes in your state of residence and in any states in which you own property.

Gift tax – The annual gift tax exclusion for 2009 is increased to \$13,000 per person. Therefore, if you are married, you can gift up to \$26,000 per donee by using the gift-splitting rules without any federal gift tax ramifications. Gifting is a good way to reduce your taxable estate and may be important in a good estate plan.

For example, the combination of the increased annual gift tax exclusion and the first-time home buyer credit may help your children buy their first home. If your child is married, you and your spouse can give the young couple \$52,000 without exceeding your annual gift tax exclusion. Assuming you act in time for the kids to close on a home by Nov. 30, 2009, add in the \$8,000 first-time home buyer credit and they have \$60,000 for a down payment on a first home.

CONCLUSION

Tax planning is not just a year-end fire drill. Now is a great time to evaluate your 2009 taxes and take measured steps to reduce your tax bill and help achieve your financial goals.

Although we have covered a number of topics in this letter, we undoubtedly did not address every issue relating to your specific situation. Please consult with your tax adviser before implementing any of these tax planning strategies.

PLEASE CALL US
WITH QUESTIONS.

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