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## 2009 Year-End Tax Planning for Individuals

As 2009 draws to a close, there is still time to reduce your 2009 tax bill and plan ahead for 2010. This letter highlights several potential tax-saving opportunities for you to consider. Please contact us if you would like to discuss specific strategies.

Because many tax benefits are tied to or limited by adjusted gross income (AGI) – IRA deductions, for example – a key aspect of tax planning is to estimate both your 2009 and 2010 AGI. Also, when considering whether to accelerate or defer income or deductions, you should be aware of the impact this action may have on your AGI and your ability to maximize itemized deductions that are tied to AGI. Your 2008 tax return and your 2009 pay stubs and other income- and deduction-related materials are a good starting point for estimating your AGI.

High-income-earners have other factors to keep in mind when mapping out year-end plans. Many observers expect top tax rates on ordinary income to increase after 2010, making long-term deferral of income less appealing. Long-term capital gains rates could go up as well, so it may pay for some to take large profits this year instead of a few years down the road. On the other hand, the solid good news high-income-earners have to look forward to next year is that there no longer will be an income based reduction on most itemized deductions, nor will there be a phase-out of personal exemptions. Additionally, traditional IRA to Roth IRA conversions will be allowed regardless of a taxpayer's income.

### Funding your retirement plans

Contributions to a tax-qualified retirement plan can reduce your current tax obligations and help with saving for the future in a tax-efficient manner. Keep in mind that retirement plans must be in place by December 31, 2009 in order to qualify for the 2009 deductions. Exceptions to this are IRAs and SEP plans which must be in place by April 15, 2010.

For 2009, the following limits apply:

<i>Type of Plan</i>	<i>Contribution Limit</i>	<i>Contribution Limit – Age 50 or Older</i>
IRA	\$5,000	\$6,000
Simple IRA	\$11,500	\$14,000
§401(k)	\$16,500	\$22,000



Self-employed individuals with a §401(k) plan can contribute up to 20 percent of their self-employment income (to a maximum of \$49,000).

*Traditional IRA:* Individuals who are not active participants in an employer pension plan may make deductible contributions to an IRA. Individuals who are active participants in an employer pension plan also may make deductible contributions to an IRA, but their contributions are limited in amount depending on their AGI. For 2009, the AGI phase-out range for deductibility of IRA contributions is between \$55,000 and \$65,000 of modified AGI for single persons (including heads of households), and between \$89,000 and \$109,000 of modified AGI for married filing jointly. Above these ranges, no deduction is allowed.

*Roth IRA:* Earnings grow tax-free, and distributions are tax-free provided no distributions are made until more than five years after the first contribution and the individual has reached age 59 ½. Distributions may be made earlier on account of the individual's disability or death. Contributions to Roth IRAs are nondeductible. The maximum contribution is phased out for persons with an AGI above certain amounts: \$166,000 to \$176,000 for married filing jointly, and \$105,000 to \$120,000 for single taxpayers (including heads of households); and between \$0 and \$10,000 for married filing separately who lived with the spouse during the year.

*Roth IRA Conversion Rule:* Funds in a traditional IRA (including SEPs and SIMPLE IRAs), §401(a) qualified retirement plan, §403(b) tax-sheltered annuity or §457 government plan may be rolled over into a Roth IRA. Such a rollover, however, is treated as a taxable event, and you will pay tax on the amount converted. No penalties will apply if all the requirements for such a transfer are satisfied.

A taxpayer's AGI (whether married filing jointly or single) is limited to \$100,000 to make such a conversion and the taxpayer must not be married individual filing a separate return. The AGI limitation does not apply to conversions from a Roth designated account in a §401(k) or §403(b) plan. Beginning in 2010, the \$100,000 income limit on Roth IRA conversions is repealed, and taxpayers will be able to make Roth IRA conversions without regard to their AGI. If you are eligible to convert to a Roth IRA in 2010, you will have the option of spreading the income ratably over two taxable years (2011 and 2012). This is a complicated calculation and we should meet to determine what your best options are.

*Required Minimum Distributions:* For 2009 only, taxpayers may waive taking their required minimum distribution. Thus, for 2009, no minimum distribution is required from IRAs or defined contribution plans (§401(k) plans, §403(a) and (b) annuity plans, and §457(b) plans that are maintained by a governmental employer). As a result, a person who attains age 70 ½ in 2009 is not required to take a distribution by April 1, 2010. This provision will help keep your AGI low as your taxable income will not have to absorb a distribution from your retirement account.



### **Deferring Income to 2010 or Accelerating Income into 2009**

If you expect your AGI to be higher in 2009 than in 2010, or if you anticipate being in the same or higher tax bracket in 2009, you may benefit by deferring income into 2010. Deferring income will be advantageous so long as the deferral does not bump your income to the next bracket. One way to defer income is to delaying billing if you are self-employed so payments will not be received until 2010.

In limited circumstances, you may benefit by accelerating income into 2009. For example, you may anticipate being in a higher tax bracket in 2010, or perhaps you will need additional income in order to take advantage of an offsetting deduction or credit that will not be available to you in future tax years. Before deciding to go this route, please contact our office so we can look at your individual tax situation and estimate your potential tax savings.

### **Deduction Planning – Individual Deductions**

Deduction timing is also an important element of year-end tax planning. Deduction planning is complicated due to factors limiting deductions, such as AGI levels and filing status. In order to have deductions eligible to be counted for 2009, ensure the deduction items have been paid by year-end. A credit card can be used to prepay expenses to generate deductions in the current year.

*State Taxes:* If you anticipate a state income tax liability for 2009 and plan to make an estimated payment, consider making the payment before the end of 2009; however, if you expect to be subject to the alternative minimum tax (AMT) in 2009, this negates the benefit of prepaying your state income tax liability in 2009. Note that in 2009 (but not in 2010), you can elect to deduct as an itemized deduction state and local sales taxes instead of state and local income taxes. Sales tax paid on big ticket items purchased in 2009 can be included in addition to the amounts on the IRS sales tax tables.

*Charitable Contributions:* Consider making your charitable contributions at the end of the year. You can use a credit card to charge donations in 2009 even though you will not pay the bill until 2010. A mere pledge to make a donation is not deductible, however, unless it is paid by the end of the year. For claimed donations of cars, boats and airplanes of more than \$500, the amount available as a deduction will significantly depend on what the charity does with the donated property, not just the fair market value of the donated property. If the organization sells the property without any significant intervening use or material improvement to the property, the amount of the charitable contribution deduction cannot exceed the gross proceeds received from the sale.



In addition, please remember the following rules as they relate to charitable contributions: (1) no deduction is allowed for charitable contributions of clothing and household items if such items are not in good used condition or better; (2) the IRS may deny a deduction for any item with minimal monetary value; and (3) the restrictions in (1) and (2) do not apply to the contribution of any single clothing or household item for which a deduction of \$500 or more is claimed if the taxpayer includes the qualified appraisal with the return. Charitable contributions of money, regardless of the amount, will be denied a deduction, unless the donor maintains a cancelled check, bank record, or receipt from the donee organization showing the name of the donee organization, and the date and amount of the contribution.

### **Deduction Planning – Business Deductions**

*Self-Employed Health Insurance Premiums:* Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses and dependents as an above-the-line deduction, without regard to the 7.5% of AGI floor.

*Equipment Purchases:* If you are in business and purchase equipment, you may make a “Section 179 Election,” which allows you to expense (i.e. currently deduct) otherwise depreciable business property. For 2009, you may elect to expense up to \$250,000 of equipment costs if the asset was placed into service during 2009. This amount drops to \$125,000 in 2010.

*Bonus Depreciation:* For 2009, taxpayers meeting certain criteria can claim a 50% bonus depreciation allowance. One of the criteria is the taxpayer must begin the original use of the property.

### **Education and Child Tax Benefits**

*Child Tax Credit:* A tax credit of \$1,000 per qualifying child under the age of 17 is available on this year’s return. In order to qualify for 2009, the taxpayer must be allowed a dependency deduction for the qualifying child. The credit is phased out at a rate of \$50 for each \$1,000 (or fraction of \$1,000) of modified AGI exceeding the following amounts: \$110,000 for married filing jointly; \$55,000 for married filing separately; and \$75,000 for all other taxpayers. A portion of the credit may be refundable. For 2009, the threshold earned income level to determine refundability is \$3,000.

*American Opportunity Tax (HOPE) Credit and Lifetime Learning Credit:* The maximum HOPE credit for 2009 is \$2,500 (100% on the first \$2,000, plus 25% of the next \$2,000) for qualified tuition and fees paid on behalf of a student who is enrolled on at least a half-time basis. The credit is available for the first four years (rather than two as in past years) of the student’s post-secondary education. For 2009, the credit is phased out at modified AGI levels between \$160,000 and \$180,000 for joint filers, and between \$80,000 and \$90,000 for other taxpayers.



Forty percent of the HOPE credit is refundable, which means you can receive up to \$1,000 even if you owe no taxes. The term “qualified tuition and related expenses” has been expanded to include expenditures for “course materials” (books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance).

The Lifetime Learning credit maximum in 2009 is \$2,000 (20% of qualified tuition and fees up to \$10,000). A student need not be enrolled on at least a half-time basis so long as he or she is taking post-secondary classes to acquire or improve job skills. For 2009, the Lifetime Learning credit is phased out at modified AGI levels between \$100,000 and \$120,000 for joint filers, and between \$50,000 and \$60,000 for single taxpayers.

*Kiddie Tax:* For 2009, the kiddie tax applies to: (1) children under 18; (2) 18-year old children who have unearned income in excess of the threshold amount, do not file a joint return and who have earned income, if any, that does not exceed one-half of the amount of the child’s support; and (3) children between the ages of 19 and 23 and if, in addition to the above rules, they are full-time students. For 2009, the kiddie tax threshold amount is \$1,900.

## **Energy Incentives**

*Nonbusiness Energy Property Credit:* After expiring in 2007, the nonbusiness energy property credit was re-enacted for 2009 and 2010 only. Property qualifying for the credit includes windows (including skylights), exterior doors, insulation, metal roof, advanced main air circulating fans, natural gas, propane, or oil furnace or hot water boilers, and other energy efficient building property that meets certain energy standards. The credit is 30% of the cost of the improvement(s) up to a maximum credit per year of \$1,500.

## **Investment Planning**

The following rules apply for most capital assets in 2009:

- Capital gains on property held one year or less are taxed at an individual’s ordinary income tax rate.
- Capital gains on property held for more than one year are taxed at a maximum rate of 15% (0% if an individual is in the 10% or 15% marginal tax bracket-reduced).

*Purchasing a Home:* If you purchased a home, or are planning to purchase a home in 2009, you may be eligible for up to an \$8,000 credit if you are a qualified first-time homebuyer. One qualification is that your modified adjusted gross income must be less than \$125,000 (\$225,000 if married filing jointly). The credit, originally set to expire December 1, 2009, has been extended for homes purchased (or under binding contract and closed before July 1, 2010) to May 1, 2010.



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In addition, the credit has been modified to apply not just to first-time homebuyers. Taxpayers who have owned and lived in their old house for any five consecutive years within the preceding eight years will be treated for purposes of the credit as first-time homebuyers. However, instead of the full \$8,000 credit, such long-term residents are eligible for only a \$6,500 credit.

*Social Security:* Depending on the recipient's modified AGI and the amount of Social Security benefits, a percentage – up to 85% – of Social Security benefits may be taxed. To reduce that percentage, it may be beneficial to defer receipt of other retirement income. One way to do so is to elect to receive a lump sum distribution from a retirement plan and to rollover that distribution into an IRA. Alternatively, it may be beneficial to accelerate income so as to reduce the percentage of your Social Security taxed in 2010 and later years.

### **Alternative Minimum Tax**

Thanks to another legislative amendment in early 2009, the alternative minimum tax exemption amounts will be high enough to spare millions of taxpayers from the AMT effect. The exemption amounts are: (1) \$70,950 for married individuals filing jointly and for surviving spouses; (2) \$46,700 for unmarried individuals other than surviving spouses; and (3) \$35,475 for married individuals filing a separate return. Also, for 2009, nonrefundable personal credits can offset an individual's regular and alternative minimum tax.

If you have any questions, please do not hesitate to call. We would be happy to meet with you at your convenience to discuss the strategies outlined above. There is still time to implement these strategies to minimize your 2009 tax liability.

*The tax laws referred to above include many complex rules and definitions; therefore, each person should consult their tax advisor regarding the proper application of these laws to their individual tax situation.*

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