



# Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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## Year-End Tax-Saving Strategies to Keep Your 2009 Tax Bite Low

With the sluggish economy, 2009 has not been a great year for most individuals. Unemployment is up, incomes are lower, retirement savings have declined, and many taxpayers are struggling to make ends meet. The government has provided a variety of tax incentives to help weather the economic storm, and you are urged to take advantage of these special tax benefits as well as other strategies to keep your 2009 tax bite as low as possible. Note: Some of the strategies below deal with ways to increase a taxpayer's itemized deductions.

**State Estimated Tax Payments** – Although the deadline to make the fourth-quarter 2009 state estimated tax payment is January 15, 2010 for most states, the payment will count as a tax deduction on the federal Schedule A for 2009 if that payment is made before the end of December 2009.

**Property Taxes** – Generally, your property taxes are billed in installments, and that is how most people pay them. However, the tax can be paid all at once, if it provides a greater tax benefit for the current year.

**Caution:** The preceding two strategies do not benefit taxpayers who are subject to the alternative minimum tax (AMT), since taxes are not deductible to the extent a taxpayer is subject to the AMT. Taxpayers subject to the AMT might, instead, consider deferring deductible tax payments to the subsequent year.

**Required Minimum Distributions (RMDs) from Retirement Plans** – Except for delayed 2008 distributions, RMDs are not required for 2009. Congress enacted this one-year relief so that an individual's retirement accounts could

recover from the market downturn. However, if you are in a low or zero tax bracket, it may be to your benefit to take a withdrawal anyway. RMDs generally apply to individuals age 70½ and older, but even younger retirees who are not yet required to take a distribution may find this strategy beneficial. If you receive Social Security benefits, IRA distributions can sometimes be planned to minimize the taxability of the Social Security income.

**Tax Credit for First Four Years of College** – The new American Opportunity Credit (AOC) takes the place of the Hope education credit and provides a credit for tuition and certain other expenses of the first four years of college (Hope only applied to the first two years). So even if you used the Hope credit in prior years, you can qualify for the AOC. The credit is 100% of the first \$2,000 of qualified expenses and 25% of the next \$2,000. Forty percent of the credit is refundable, which means that taxpayers with little or no tax liability can still benefit from the credit. Where appropriate, taxpayers can prepay the tuition for academic terms starting in the first three months of 2010 to help maximize the benefit for 2009. This credit does begin to phase-out for single taxpayers with AGI above \$80,000 (\$160,000 for joint filers), and no credit is allowed for taxpayers filing married separately.

**Energy-Efficient Home Improvements** – Homeowners who have or will make certain energy-efficient improvements to their existing homes may qualify for energy credits up to 30% of the cost (credit limited to \$1,500). This credit applies to the following qualified energy-efficient improvements: exterior windows and skylights, exterior doors, metal and

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strategy



# 2010 Brings Liberalized IRA-to-Roth-IRA Conversions

**N**ext year will be a pivotal one for retirement planning, as it will be the first year in which taxpayers will be able to convert funds in regular IRAs (as well as qualified retirement plans) to Roth IRAs, regardless of their income level.

This new conversion option poses significant tax planning challenges and opportunities for 2009, 2010 and 2011. Presently (in 2009), taxpayers with modified adjusted gross income (AGI) <sup>(1)</sup> in excess of \$100,000 may not convert investments in traditional IRAs into investments in Roth IRAs. This includes converting amounts from SEP-IRAs or SIMPLE IRAs.

There are two big advantages of the Roth IRA: all future earnings and distributions at retirement will be tax-free, and the Roth IRAs are not subject to the required minimum distribution rules. Although conversions are taxable, except for previously nondeductible amounts, they are not subject to the 10% premature distribution tax.

**Big Changes Coming Next Year** – For tax years beginning after 2009, the \$100,000 modified AGI limit on conversions of traditional IRAs to Roth IRAs is eliminated. Additionally, married taxpayers filing separate returns will be able to convert amounts in a traditional IRA into a Roth IRA (currently, they are barred from doing so).

There are other tax advantages. Because distributions from Roth IRAs are tax-free (if they are qualified distributions), they may keep a taxpayer from being taxed in a higher tax bracket than would otherwise apply if he were withdrawing taxable distributions, which do not enter into the calculation of tax owed on Social Security payments, and have no effect on AGI-based deductions. Even better, the benefits flow through to beneficiaries of Roth IRA accounts, who also can make tax-free

withdrawals from such accounts (they are, however, subject to the same annual post-death minimum distribution rules that apply to beneficiaries of regular IRAs).

**Should You Make an IRA-to-Roth-IRA Conversion?** Generally, taxpayers with the following tax profiles should consider making a conversion:

- Taxpayers who still have a number of years to go before retirement and have time to recoup the conversion tax dollars;
- Are in a lower than normal tax bracket in the year of conversion;
- Anticipate being taxed in a higher bracket in the future; and
- Can pay the tax on the conversion from funds other than non-taxed retirement funds.

**Complicating Factor for 2010 Conversions** – A unique income inclusion rule will apply for IRA-to-Roth-IRA conversions occurring in 2010. Unless a taxpayer elects otherwise, none of the gross income from the conversion is included in income in 2010; half of the income resulting from the conversion will be includible in gross income in 2011, and the other half in 2012. This requires some careful planning, since, without Congressional action, the current lower tax brackets of 35%, 33%, 28% and 25% will revert to their pre-2001 levels of 39.6%, 36%, 31% and 28% after 2010.

**What to Do This Year** – Taxpayers who intend to take advantage of the new conversion option next year should consider the following strategies:

- Non-high-income taxpayers who are able to make deductible IRA contributions this year should do so. They will reduce their 2009 tax bill and, if they make the conversion to a Roth IRA next year, they won't have to pay back the tax savings until 2011 and 2012.
- High-income taxpayers should consider making nondeductible IRA contributions this year. They can then roll over the accounts into Roth IRAs next year at no tax cost.
- High-income taxpayers planning to make large conversions in 2010, and pay the tax in 2010 rather than deferring the tax until 2011 and 2012, should avoid the standard year-end-planning wisdom of accelerating deductions and deferring income. Instead, they should consider doing the reverse, accelerating income into 2009 and deferring deductions until 2010 to help reduce the conversion tax in 2010.

Conversions can be tricky! So if you are considering a conversion in 2010, it might be appropriate to call for an appointment so this office can help you properly analyze your conversion options.

<sup>(1)</sup> With respect to conversions to Roth IRAs, the AGI is modified by eliminating a number of income exclusions, but does not include the income resulting from the conversion itself, nor does it include any required minimum distributions.

## Don't Expect Huge Tax Savings with Low Inflation Rate in 2010

To keep taxpayers from being pushed into higher tax brackets or from losing tax benefits simply because of inflation, the federal tax code since the 1980s has included inflation adjustments for tax brackets, exemptions, high-income phase-outs of various deductions and limitations, allowable retirement savings and the annual gift-tax exclusion, just to mention a few. For example, indexing tax brackets lowers tax bills when there is inflation by including more of one's income in a lower bracket, such as the 15% rather than the 25% bracket.

In 2010, for the first time ever, those inflation adjustments will be virtually nil because of a very low inflation rate. This means that taxpayers with the same taxable income in 2010 as in 2009 will not see much of a tax savings due to inflation. For example, joint filers with a taxable income of \$100,000 will pay approximately \$13 less in income taxes in 2010 than on the same income for 2009, compared with a \$313 savings between 2008 and 2009. A single filer with taxable income of \$50,000 will owe \$6 less next year, compared to a \$156 savings due to the significantly higher inflation rate between 2008 and 2009.

The lack of change for 2010 creates a level playing field for taxpayers from all brackets, but those with high incomes actually stand to benefit in 2010 because "stealth taxes," those that don't involve changing tax rates, are being phased out. Among them are limits on itemized deductions and personal exemption amounts.

## *(Year-End Tax-Saving Strategies to Keep Your 2009 Tax Bite Low Cont'd)*

asphalt roofs, heating systems, air-conditioning systems and insulation. With many contractors without work, this could be an opportune time to negotiate reasonable prices and make those home modifications, but the work must be completed before the year's end if you want a credit in 2009.

**Roth IRA Conversions** – If your taxable income is low or a negative amount for the year, it may be appropriate to convert some or all of your taxable traditional IRA to a Roth IRA for little or no tax cost.

**Review Estimated Tax Payments and Withholding** – You should ensure that your estimated tax payments and withholding are sufficient to meet the “safe-harbor” payment amounts so as to avoid underpayment penalties. This is important this year because the federal government modified the withholding tables to account for the new “Making Work Pay Credit,” resulting in reduced withholding and possible underpayments, especially in cases where a taxpayer has two jobs or both spouses are employed.

**IRA and Self-Employed Retirement Plan Contributions** – The primary purpose of IRA and self-employed retirement plans is to provide for your future retirement; whenever you are eligible and financially able, you should always contribute as much as possible. Contributions also provide a tax deduction when they are made to self-employed plans and to most traditional IRAs. The benefit derived from this tax deduction is based upon your tax bracket. (Some contributions to traditional IRAs may not be deductible if you also participate in another retirement plan, depending on your income level.) If 2009 was not a good year financially for you, the deduction may not be significant, and you may wish to consider making a Roth IRA contribution instead. An individual who simply prefers the Roth option, but is barred from making Roth contributions because his income exceeds the AGI phase-out limitations, might consider making a nondeductible traditional IRA contribution and then converting it to a Roth IRA in 2010 when the Roth IRA AGI limitations are removed.

**Capital Loss Carryovers** – If you have carryover capital losses, remember that you can only claim a maximum of \$3,000 net capital loss on your return and that the remainder carries over to the subsequent year. However, with the market's recent rally, you may have some gains you can take to offset the carryover. (If you sell at a gain but wish to repurchase stock in the same company, note that the wash sale rules don't apply – they only apply to losses – so you will not need to wait 30 days to make the repurchase.) For long-term planning, it is important to keep in mind that the current lower capital gains rates of 0% and 15% are only available through 2010. After that, without Congressional intervention, the rates return to the pre-2003 levels of 10% and 20%.

**Non-Cash Charitable Donations** – If you itemize your deductions and your garage and closets contain never-used items, consider donating those items to charity before the year-end to increase your deductions for 2009. To claim a deduction for donated clothing and household goods, they must be in good condition or better, and the donations must be substantiated by a written receipt that includes the name of the charity, dates and location of the donation and a reasonably detailed description of the property donated. A receipt is not required where the value is less than \$250 and it is impractical to obtain one (for example, when items are left at an unattended drop site). If, instead, you decide to sell some of the property, the income is generally tax-free, provided each item is sold for less than your cost or basis in the property.

**Deduct IRA Losses** – If a traditional IRA account that includes nondeductible contributions declines in value and the value of all of your IRA accounts combined is less than the sum of your nondeductible contributions, you can take a loss by withdrawing from (close out) all your IRA accounts. However, this loss is beneficial only if you itemize your deductions and the loss, along with your other miscellaneous deductions, exceeds 2% of your income (AGI) for the year.

The foregoing are frequently-encountered tax strategies that can be employed by most, but by no means all, taxpayers. Please call this office if you have questions regarding any of the topics discussed or would like to engage in some year-end tax planning. If you have a substantial increase or decrease in income this year, it may be wise to schedule an appointment before the holidays to strategize.

# Should You Itemize or Take the Standard Deduction in 2009?

Most taxpayers have annually had the option to itemize their deductions or take a standard deduction, and the rationale for making the choice has always been rather simple: take the higher of the two amounts. However, for 2009, the choice can be complicated, and, in some cases, requires advanced planning to maximize the tax benefits of that choice.

The complications have been brought about by the ability, in 2009, to add real property taxes, new vehicle sales and excise taxes, and disaster casualty losses to the standard deduction, creating a hybrid deduction that is part standard and part itemized. Consequently, the decision becomes more difficult, especially when deciding whether to buy a new car this year or not; pay all the property taxes or only the first installment this year; and exercise the option to take a 2009 disaster loss in the current year or the preceding year.

Some taxpayers who only marginally itemize each year have adopted the strategy of “bunching” deductions in one year and then claiming the standard deduction in the alternate year. This technique is applied to tax payments, charitable contributions, some medical expenses and to certain business expenses. Those employing this technique may need to reevaluate their strategy for 2009, take the hybrid standard deduction, and defer the other deductible payments into 2010.

When making the analysis, keep in mind: (1) the property tax add-on to the standard deduction is limited to \$500 for single taxpayers and \$1,000 for married taxpayers filing jointly, and (2) the vehicle tax is only allowed for the sales or excise tax paid on the first \$49,500 of the purchase price for each new vehicle bought after February 16, 2009 and through the end of the year, and it begins to phase-out for single taxpayers with an AGI above \$125,000 (\$250,000 for married taxpayers).

If you marginally itemize your deductions, it may be appropriate for you to schedule a consultation with this office prior to the holidays, and defer tax-deductible payments and buying a car until after a strategy has been determined for your particular circumstances.



# Tax calendar

Nov. 2009 – Apr. 2010

## November-December 2009:

It's time for 2009 year-end and 2010 tax planning. This is highly recommended if you have substantial increases in income or fewer deductions. Please call for an appointment.

## December 31, 2009:

- This is the last day to pay deductible expenses for the 2009 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2009.
- This is the last day to set up a Keogh Retirement Account if you plan to make a 2009 contribution.

## January 15, 2010:

The fourth quarter 2009 federal estimated tax payment is due unless the 2009 return is filed by February 1, 2010. Caution: Some states may have different filing dates for state estimated payments.

## February 1, 2010:

This is the deadline for providing 1099s and W-2s to those people you paid during 2009. If you are a business owner or rental property owner and you paid \$600 or more for the services of individuals (other than

employees) during the year, you will need to provide 1099s to those workers by February 1, 2010. Note that the normal due date is January 31, but because it falls on a weekend, the due date is the next business day, February 1. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by March 1, 2010. This firm can prepare these documents for you.

## March 1, 2010:

This is the deadline for filing (sending) 1099s and W-2s to the government. Note that the normal due date is February 28, but because it falls on a weekend, the due date is the next business day, March 1.

## April 15, 2010:

- This is the deadline for individuals to file a 2009 federal return or request an extension of time to file.
- The first installment of the 2010 federal estimated tax payment is due. Caution: Some states may have different filing dates for state estimated payments.
- The first installment of the 2010 defined benefit pension plan contributions is due.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

# Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

Since You  
Asked...

**You Asked:** This year I purchased a houseboat that I use as my home. Do I qualify for the first-time homebuyer credit?

**Answer:** In addition to a conventional single family residence, the credit also applies to the purchase of a house trailer, mobile home, houseboat, cooperative apartment, condominium, duplex, or row house used as a taxpayer's primary residence. So, if the houseboat is your primary residence and was purchased between January 1, 2009 and November 30, 2009, and you and your spouse (if married) have not owned a home in the three years prior to the houseboat's purchase, you probably qualify for the credit. The credit is phased out for higher-income taxpayers. Only the purchase of a main home located in the United States qualifies. Vacation homes and rental properties are not eligible.

**You Asked:** My spouse and I both lost our jobs this year and are receiving unemployment benefits. Do we have to pay tax on this income?

**Answer:** For 2009, federal law allows each spouse to exclude the first \$2,400 of unemployment benefits; the rest is taxable. For example, if your unemployment benefits were \$2,000 and your spouse's were \$3,000, you would be able to exclude all of your unemployment benefits and \$2,400 of your spouse's for a total exclusion of \$4,400 on your jointly-filed federal return. That leaves \$600 of the benefits being taxable. Many states, including California, do not tax unemployment benefits at all.

