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2010 YEAR-END INCOME TAX PLANNING FOR “INDIVIDUALS”

As we approach the close of 2010, there is still time to take steps that can reduce your 2010 tax bill. Year-end tax planning is more complicated this year due to: ongoing uncertainties regarding tax rates for 2011; questions as to when and if many popular tax breaks that expired last year will be extended; and short windows of opportunity to take advantage of recently-enacted tax breaks that are scheduled to expire after 2010. As we complete this document, there is no assurance that Congress will resolve these issues by the end of this year. However, regardless of how and when these uncertainties are addressed, there are many “tried and true” year-end tax savings steps that you should consider for 2010, no matter what action Congress ultimately takes. Moreover, Congress has passed several tax bills this year that offer new tax breaks to individuals, many of which are temporary, and some that are available **in 2010 only!**

We are providing you this information to remind you of the *traditional* year-end tax planning strategies that **1)** help ensure your income is taxed at lower rates, and **2)** will, in some cases, postpone taxes by deferring your taxable income and accelerating your deductions (so long as deferring income does not expose you to a significantly higher tax bracket in later years). This document will also help you navigate through the many *new* tax planning opportunities available to individuals under recent law changes. **Caution!** Since many recently-enacted tax breaks **expire after 2010** (and others after 2011), it is extremely important that you be proactive and act timely to obtain maximum benefits! **Tax Tip.** Even though the recent recession has caused many individuals to experience a significant drop in income for 2010, this drop in income may actually produce additional tax benefits. If your income is down for 2010 as compared to recent years, you may be eligible for deductions and credits that you did not get in previous years because your income exceeded the phase-out thresholds. So, **pay close attention to the income thresholds** for the various deductions and credits discussed in this document, which we **highlight prominently** in each section.

Planning Alert! Tax planning strategies suggested in this document may subject you to an unexpected alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, certain standard deductions, state and local income taxes, and real estate taxes. Also, AMT can be triggered by taking large capital gains or exercising incentive stock options. Tax planning strategies we have suggested may subject you to an unexpected alternative minimum tax (AMT). Therefore, **we suggest that you call our firm before implementing any tax planning technique discussed in this document.** You cannot properly evaluate a particular planning strategy without calculating your overall tax with and without that strategy.

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HIGHLIGHTS OF RECENT LEGISLATION IMPACTING YEAR-END PLANNING

Congress passed three significant tax bills this year: **1) The *Hiring Incentives Act of 2010*** (HIRE Act) to promote hiring; **2) The *Health Care Act of 2010*** (Health Care Act) to overhaul the health care industry (which also contains an array of tax provisions), and **3) The *Small Business Jobs Act of 2010*** (Jobs Act) providing a series of tax incentives to small businesses to help spur economic activity. Collectively, these tax bills contain several new temporary tax breaks for individuals. The following are *selected* provisions from this tax legislation that we believe will have the greatest impact on your 2010 year-end planning.

Self-Employed Individuals May Deduct Health Insurance In Calculating Self-Employment Taxes For 2010 Only. For tax years beginning in 2010, the *Jobs Act* allows self-employed individuals to deduct their health insurance premiums for S/E (Social Security and Medicare) tax purposes, as well as for regular income tax purposes. **Planning Alert!** For 2010, the S/E tax rate is 15.3% for the first \$106,800 of self-employed income, and 2.9% on the income exceeding \$106,800. Thus, if your self-employed income for 2010 does not exceed \$106,800, this temporary deduction will generally save you S/E tax equal to 15.3% of the cost of your health insurance. However, since you are also allowed an "income tax" deduction for one-half of your S/E tax, this *income tax* deduction will likewise be reduced by one-half of any reduction in your S/E tax. **Tax Tip.** If you are self-employed and you are planning to pay health insurance premiums in the early part of 2011, **accelerating that payment into 2010** will salvage a deduction for S/E tax purposes.

Rules For Cell Phones Relaxed. Effective for tax years beginning after 2009, the *Jobs Act* provides that cell phones and similar telecommunications equipment (including PDAs and Blackberry devices) are no longer classified as "listed property". In order to obtain a deduction for the business use of listed property, detailed contemporaneous record keeping is required. Therefore, after 2009, the general documentation rules for business deductions apply to cell phones and similar devices used for business.

Reimbursements Of Over-The-Counter Drugs No Longer Tax Free. Before the *Health Care Act*, taxpayers were allowed tax-free reimbursements for most *nonprescription* drugs and medicines from a health savings account (HSA), health flexible spending arrangement (FSA), health reimbursement arrangement (HRA), or other qualified employer health plans. **Effective for expenses incurred after 2010**, reimbursements for drugs and medicines will be tax free *only for* a prescribed drug or insulin. **Planning Alert!** If you have been using a tax-favored reimbursement arrangement to pay for your over-the-counter medications (e.g., to treat a chronic medical problem such as allergies or asthma), these reimbursements will generally be taxable **starting in 2011**, unless you have a prescription. **Tax Tip.** The IRS has stated that you may receive tax-free reimbursements **after 2010** for non-prescription drugs **that you purchased on or before December 31, 2010**. So, you may want to stock up on any nonprescription drugs that you may need **before 2011**, even though your reimbursement is expected after 2010.

Tax-Free Medical Benefits Extended To Children Under Age 27. Effective March 30, 2010, the *Health Care Act* allows tax-free reimbursements from an employer-provided health plan to any child of an employee **who is not age 27 as of the end of the tax year**. This exclusion applies even if the employee cannot claim the child as a dependent for tax purposes, as required under previous law.

Adoption Credit Increased And Made Refundable For 2010 And 2011. For tax years beginning in 2010 or 2011, the *Health Care Act* makes two significant changes to the adoption credit: **1) the maximum adoption tax credit is increased to \$13,170**, and **2) the credit becomes "refundable"** (this generally means that, to the extent the credit exceeds your income taxes before the credit, the IRS will send you a check for the excess). For 2010, the adoption credit is phased-out as your modified adjusted gross income increases from **\$182,520 to \$222,520** (whether you're married filing a joint return, or single). **Tax Tip.** Generally, for domestic adoptions, you are allowed the adoption credit in the tax year *following the year* the qualifying adoption expense is "paid." However, the credit is allowed for adoption expenses paid in the same tax year that the adoption is finalized. Therefore, qualified expenses of a domestic adoption paid **by December 31, 2010** will generally generate a refundable credit **in 2011**. However, if you can *finalize* the adoption **on or before December 31, 2010**, you can generate a refundable credit **in 2010**.

New Law Clarifies Tax Treatment Of “Partial” Pay Out Option By Nonqualified Annuity Contracts.

If you receive annuity payments from your tax-deferred, nonqualified annuity contract (i.e., held outside of a qualified retirement plan or IRA), a portion of each payment representing your investment in the annuity is generally excluded from income based on an “exclusion ratio.” **For amounts received in tax years beginning after 2010**, the *Jobs Act* permits you to receive *a part of* the annuity in the form of a stream of annuity payments, provided that the annuity payments are for a period of *at least* 10 years, or during one or more lives. **Tax Tip.** This welcomed change will make it easier to annuitize *a portion* of an annuity contract while allowing the remaining amount to grow tax-deferred. **Please call** our firm if you need additional information.

“Qualified Small Business Stock” Exclusion Temporarily Increased To 100%. As a result of the *Jobs Act*, if you sell “qualified small business stock” (QSBS) **acquired after September 27, 2010 and before January 1, 2011**, you will be able to exclude the **entire gain** from taxable income (the gain will also be exempt from the alternative minimum tax). QSBS is generally stock of a non-publicly traded domestic “C” corporation engaged in a qualifying business, purchased directly from the corporation, **held for more than 5 years**, where the issuing corporation meets certain active business requirements and owned assets at the time the stock is issued of \$50 million or less. Businesses engaged in a professional service, banking, hotel, motel, restaurant, or farming activity generally *do not* qualify. **Planning Alert!** If you are considering investing in a small business, we would be glad to help you evaluate whether structuring your investment as QSBS will work to your overall tax advantage. However, you must act promptly to take advantage of this narrow window of opportunity to qualify for the 100% exclusion (only stock acquired **from September 28, 2010 through December 31, 2010** qualifies). Also, to qualify, you must purchase the stock directly from the corporation that is issuing the stock or an underwriter of the stock (stock purchased from other third parties does not qualify).

PAY CLOSE ATTENTION TO EXPIRING (AND EXPIRED) INDIVIDUAL TAX BREAKS

Selected Individual Tax Breaks That Expired At The End Of 2009. Congress has given us an ever-expanding list of temporary tax breaks that expire every few years. However, even though it often waits until the last minute, Congress has historically extended most of the more popular provisions before they actually expire. Unfortunately, Congress has yet to extend most of these commonly-used tax breaks that **expired at the end of 2009**. The following is a list of some of the more popular tax breaks that **expired at the end of 2009**: **1)** School Teachers' Deduction (up to \$250) for Certain School Supplies; **2)** Deduction for State and Local Sales Tax; **3)** Deduction (up to \$4,000) for Qualified Higher Education Expenses; **4)** Real Property Tax Standard Deduction For Non Itemizers, **5)** Qualifying Tax-Free Transfers from IRAs to Charities for Those at Least 70½; **6)** Higher Alternative Minimum Tax (AMT) Exemption Thresholds; and **7)** Increased Charitable Deduction Limits for Qualifying Conservation Easements. **Planning Alert!** If recent history is a guide, Congress will likely extend these provisions eventually, but there is no guarantee. Our firm will monitor the status of these expired provisions closely. Please call us if you want an up-to-date report.

Individual Tax Breaks That Are Currently Scheduled To Expire At The End Of 2010. With the majority of the 2001 Act tax cuts and other tax provisions scheduled to expire **at the end of 2010**, a complete listing of tax breaks that are scheduled to expire after this year is too long to put in this document. However, starting with the next segment, we discuss the most important expiring items in the remainder of this document. We also suggest steps that you should consider in 2010 to take advantage of these expiring tax breaks, in case Congress decides not to extend them beyond 2010. **Please note** that our firm will be monitoring these provisions closely. Feel free to call us if you need a status report.

PREPARING FOR POTENTIAL TAX RATE INCREASES

Unless Congress changes current law, individuals are facing an increase in their federal income tax rates beginning next year. **In 2011**, the top regular individual income tax rate on income, other than long-term capital gains, is scheduled to jump from 35% to 39.6%. The maximum tax rate on long-term capital gains is scheduled to increase from 15% to 20%. And, the top tax rate on dividends is scheduled to increase

from 15% to 39.6%. Also, starting in 2011, current law provides for a return of the provisions phasing out *itemized deductions* and *personal exemptions* for higher-income taxpayers. Consequently, **starting in 2011**, for taxpayers who are affected by these phase-out limits, the *effective* top regular income tax rate will be even higher than 39.6%. Furthermore, **starting in 2013**, the *Health Care Act* imposes a new **.9% Medicare Surtax** on the *earned income* of higher-income individuals as well as a **3.8% Medicare Surtax** on their *net investment income*.

If tax rates in fact increase in 2011, accelerating post-2010 taxable income into 2010 could save taxes for individuals subject to these higher rates. However, accelerating income into 2010 has risks, because: **1)** Congress could decide to extend the 2010 rates at least for a year or two, particularly for low and middle-income taxpayers; **2)** taxes that you might save by accelerating taxable income into 2010 are reduced by the “time value of money” benefit you give up by choosing to accelerate the payment of taxes, and **3)** accelerating income into 2010 could cause taxpayers (particularly low and middle-income taxpayers) to exceed the 2010 income thresholds that phase out valuable tax benefits (e.g., the child credit, education credits, the adoption credit, the ability to contribute to a deductible IRA, etc.).

However, at this point, it may be too early to decide whether income should be accelerated into 2010 because of scheduled 2011 rate increases. It’s possible that current rates may be extended during the “lame duck” session of Congress, or that Congress will pass legislation similar to President Obama’s proposal to only increase rates for higher income individuals. Therefore, it seems prudent to wait. However, you should be prepared to accelerate income into 2010 and possibly defer deductions until 2011, if it becomes clear that your tax rates will substantially increase after 2010. However, even if it does become clear that your tax rates will increase in 2011, a decision to accelerate income into 2010 should not be made before performing detailed income tax calculations for the current and future years with and without the acceleration of the income. Only by performing with and without calculations that consider the regular federal income tax, the alternative minimum tax (AMT), and any state or local income tax, can you be certain that accelerating income into 2010 will be beneficial. **Caution!** Even if your regular tax rates increase after 2010, if you are subject to the alternative minimum tax this year and for future years, it is possible that your alternative minimum tax rates will not increase at all. We will be ready to assist you with these calculations and with other year-end planning considerations as we approach the end of 2010.

SHOULD YOU CONSIDER CONVERTING YOUR “TRADITIONAL IRA” TO A “ROTH IRA?”

Whether to convert (rollover) your traditional IRA to a Roth IRA (Roth conversion) continues to be a hot topic, and there are many variables that impact this decision. Probably the most significant is your current tax rates as compared to the rates you expect in your retirement year. Therefore, uncertainty as to future tax rates creates a significant amount of uncertainty as to whether a Roth conversion is right for you. Prior to 2010, you were not allowed to convert your traditional IRA into a Roth IRA unless your modified adjusted gross income was \$100,000 or less. **Starting in 2010**, this income threshold is eliminated, and individuals of all income levels are allowed to convert to a Roth. **Tax Tip.** If the recession has caused a significant, but temporary, decline in your income for 2010, you may be a good candidate for converting all or a portion of your regular IRA to a Roth. This is particularly true if: **1)** your temporary drop in 2010 income places you in a much lower tax bracket than you expect in the relatively near future, **2)** you believe that the value of your IRA is currently at or near an all time low, **3)** you expect your IRA to appreciate in the relatively near future, and **4)** you have funds outside the IRA to pay the income taxes caused by the conversion and your after-tax rate of return on the outside funds is less than the rate of return in the IRA. **Planning Alert!** If you want the conversion to be effective for 2010, you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2010** (you do not have until the due date of your 2010 tax return). **Caution!** When you convert a traditional IRA to a Roth IRA, you generally must pay tax on the amount converted as if you withdrew the funds from the traditional IRA. However, if you convert in 2010, your conversion income will be included ratably in 2011 and 2012 (unless you “elect” to include the income entirely in 2010). **Caution!** Don’t attempt a Roth conversion or implement a Roth conversion strategy **without calling us first**. There is a host of factors you should evaluate before deciding to convert your traditional IRA to a Roth.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Planning With Capital Gains And Losses

Generally, the current maximum long-term capital gains rate of 15% **is scheduled to increase to 20% starting in 2011**. Lower-income taxpayers who have long-term capital gains that would otherwise be included in the 15% (or below) ordinary income tax bracket, are taxed at a zero percent rate **through 2010** (scheduled to increase to 10% **starting in 2011**).

Planning With Temporary Zero Percent Capital Gains Tax Rate. Long-term capital gains and qualified dividends that would otherwise be included in the 15% (or below) ordinary income tax bracket, are taxed at a zero percent rate. **Planning Alert!** For 2010, all ordinary income (e.g., W-2, interest income) up to \$68,000 for joint returns (\$34,000 if single) is taxed at the 15% rate, or below. Thus, taxpayers filing jointly can benefit from the zero percent capital gains rate if (and to the extent) they have 2010 ordinary taxable income under \$68,000 (\$34,000 if filing single). **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2010, may temporarily have income low enough to take advantage of the zero percent capital gains rate for 2010. If you are experiencing any of these situations, please call our firm and we will help you determine if there is a strategy for you to take advantage of these low capital gains rates. **Planning Alert!** Gains that currently qualify for the zero percent rate will be taxed at 10% starting in 2011, unless Congress extends the zero percent rate beyond 2010.

Year-End Considerations For Capital Assets. Timing your year-end sales of stocks, bonds, or other securities may save you taxes. After fully evaluating the economic factors, the following are time-tested, year-end tax planning ideas for sales of capital assets. **Caution!** Always consider the economics of a sale or exchange **first!**

- **Timing Your Capital Gains And Losses.** If you have already recognized capital gains in 2010, you should consider selling securities (that have declined in value) **prior to January 1, 2011**. These losses will be deductible on your 2010 return to the extent of your recognized capital gains, plus \$3,000. **Tax Tip.** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: American Opportunity Tuition Tax Credit, \$400/\$800 Making Work Pay Credit, \$1,000 child credit, adoption credit, etc. **Planning Alert!** If within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the “wash sale” rules (although the disallowed loss will increase the basis of your replacement stock). **Tax Tip.** If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule that applies to *gains*. Thus, you can sell stock at a gain in order to take advantage of a lower 2010 capital gains rate, or to absorb previous capital losses, and acquire the same securities within 30 days, without impacting the recognition of the gain.
- **Making The Most Of Capital Losses.** Many taxpayers still have substantial loss carry forwards coming into 2010. If your stock sales to date have created a *net* capital loss exceeding \$3,000, consider selling enough appreciated securities **before the end of 2010** to decrease your net capital loss to \$3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your *net* capital loss (in excess of \$3,000) to absorb your short-term capital gain, while preserving your favorable long-term capital gain treatment for later years. **Caution.** Joint filers are also restricted by the *net* capital loss limit of \$3,000, while married individuals filing separately are limited to \$1,500. **Planning Alert!** Your *net* short-term capital gains can be used to free up a deduction for any “investment interest” you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest. **Tax Tip.** If you are considering selling “loss” investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine which strategy will maximize your tax savings.

- **Year-End Mutual Fund Purchases.** If you are thinking about buying mutual fund shares near year-end, watch out for a common tax trap. Mutual funds typically distribute income, including capital gains, near the end of each year. If you invest in the fund near the end of the year, but on or before the record date for this payout, you generally will be taxed on a year-end distribution as if you had held the fund all year. This, in essence, treats a return of your investment as a taxable distribution. **Tax Tip.** Before investing, determine the amount and timing of any year-end payout.

Stock "Traders" Should Consider The "Mark-to-Market" Election. If you are a "trader" (instead of an "investor") in stocks, the "mark-to-market" election could possibly save you taxes. Generally, you may qualify as a "trader" if you have frequent purchases and sales of stock, you hold the stock for short-term gain (rather than long-term appreciation and dividends), and you have a high volume of stock transactions throughout the year. As a trader, you can elect (for tax purposes) to mark your stock down or up to market at year end. This election will convert what would generally be short-term capital gains and losses, into "ordinary" gains and losses. **Tax Tip.** This election could save taxes if at some point you incur significant losses. By making a timely "mark-to-market" election, you can deduct those losses as "ordinary losses," instead of being limited by the \$3,000 ceiling on net capital losses. Also, making this election **will not** subject your mark-to-market stock gains to Social Security or Medicare taxes. **Planning Alert!** Unless you made the election for a prior year, the mark-to-market election, unfortunately, must be made by the due date (without regard to extensions) of your **prior year's tax return**. Even though it is too late to make the election for 2010, you may wish to make the election by April 15, 2011, for 2011 and future years. Please call us if you think this election might save you taxes and we will be glad to fill you in on the details.

Exercising Incentive Stock Options (ISOs) Could Trigger AMT. Exercising an incentive stock option (ISO) in 2010 can generate a 2010 alternative minimum tax (AMT) if the difference between the stock's value and the exercise price is substantial. **Tax Tip.** If you exercised an ISO **in 2010** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2010 AMT tax liability if you sell the stock **on or before December 31, 2010**. Please check with us if you have exercised incentive stock options during 2010 and the price of the stock has fallen since the date of exercise.

Postponing Taxable Income

It continues to be a good idea to defer income into 2011 if you believe that your marginal tax rate for 2011 will be equal to or less than your 2010 marginal tax rate. There also appears to be a good possibility that whatever rate increases materialize after 2011 (if any) will largely target higher-income taxpayers, and lower and middle-income taxpayers could likely be spared. Also, deferring income into 2011 could also increase various credits and deductions for 2010 that would otherwise be phased out as your adjusted gross income increases. **Tax Tip.** This classic tax planning strategy may be particularly valuable for 2010 if it also keeps your 2010 income below the phase-out thresholds for the temporary *refundable adoption credit* (**expiring after 2011**), the *American Opportunity education credit* (a portion of which is temporarily *refundable through 2010*), the \$400/\$800 Making Work Pay Credit (scheduled to **expire after 2010**), or the *\$1,000 child credit* (temporary rules that make it *refundable* for more taxpayers **expire after 2010**). If, after considering the uncertainty of 2011 tax rates, you believe that deferring taxable income into 2011 will save you taxes, consider the following strategies:

- **Self-Employed Business Income.** If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2011. **Planning Alert!** If you have already received the check in 2010, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.
- **Installment Sales.** If you plan to sell certain appreciated property in 2010, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify, the gain will be taxed to you as you collect the principal payments on the note. **Planning Alert!** Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe that your chances of getting paid are at risk. **Tax Tip.** On a seller-financed

sale, most property that qualifies for the installment method also generates a long-term capital gain (e.g., closely-held stock, partnership interests except for certain recapture items, investment realty, improved realty used in a business or held for investment). As discussed above, the maximum long-term capital gains rate is presently scheduled to **increase from 15% to 20% after 2010**. You should consider this scheduled increase in the long-term capital gains rate before agreeing to accept an installment note with payments due beyond the 2010 tax year.

- **“Minimum Required Distributions” From Retirement Plans And IRAs.** If you want to postpone the distribution (and therefore the taxation) of amounts in your traditional IRA or a qualified retirement plan as long as possible, there are several things to consider. First and foremost, it is critical that you name the appropriate beneficiaries such as an individual or a “qualified trust.” If your estate is the beneficiary of your IRA or qualified plan account, your heirs will generally miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a “contingent beneficiary” in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70½, your entire retirement account generally must be distributed and taxed within **five years** after the year of your death. This will cause your beneficiaries to lose valuable tax deferral options. **Planning Alert!** The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions, **relating to retirement plans, that should be taken before the end of 2010:**
- **Post Mortem Planning For Retirement Plan And IRA Distributions.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2010, there are certain planning techniques you should consider as soon as possible. **Tax Tip.** If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2010, the best tax results can generally be achieved by making any necessary changes **no later than December 31, 2010**. If you need assistance, please call our office as soon as possible so we can advise you.
- **Retirement Plan And IRA Owners Who Attain Age 70½ During 2010.** If you reached age 70½ at any time during 2010, you must begin distributions from a traditional IRA account **no later than April 1st of 2011**. A 50% penalty applies to the excess of the required minimum distribution over the amount actually distributed. If you wait until 2011 to take your first payment, you will still be required to take your second required minimum distribution no later than December 31, 2011, which will cause you to take two payments in 2011. This “bunching” of the first two annual payments into one tax year (2011) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2010. Since tax rates are currently scheduled to increase in 2011 (particularly for higher-income taxpayers), waiting until 2011 to take your first required payment could generate unnecessary taxes. **Tax Tip.** If you reached age 70½ in 2010, and you own an IRA or other qualified retirement account, please call us and we will help you navigate these rules to your best advantage.
- **Rollovers By Surviving Spouses.** If a taxpayer over age 70½ died during 2010 and the beneficiary of the decedent’s IRA or qualified plan is the surviving spouse, and the surviving spouse is over 59½, the surviving spouse should consider rolling the decedent’s qualified plan or IRA amount into his or her name **on or before December 31, 2010**. If the decedent’s retirement account is rolled into an IRA in the surviving spouse’s name **before 2011**, then **1)** if the surviving spouse is not at least age 70½, no distributions are required in 2010, and **2)** if the surviving spouse is at least 70½, the required minimum distribution in 2010 will be determined using the Uniform Lifetime Distribution Table rather than the surviving spouse’s single life expectancy. **Therefore, converting the account into the surviving spouse’s name on or before December 31, 2010, could substantially reduce the amount of the required minimum distribution for 2011 where the decedent was at least 70½.** **Planning Alert!** If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the

retirement account before age 59½. If the account is transferred into the spouse's name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty unless made as a series of payments based on the surviving spouse's life expectancy.

Taking Advantage Of Deductions

Accelerating “Above-The-Line” Deductions Into 2010. As a cash method taxpayer, you can generally accelerate a 2010 deduction into 2010 by “paying” it in 2010. Accelerating an “**above-the-line**” deduction (e.g., IRA or Health Savings Account (HSA) deduction, health insurance premiums for self-employed individuals, qualified student loan interest, qualified moving expenses, deductible alimony) into 2010 may allow you to reduce your “adjusted gross income” (AGI) below the thresholds needed to qualify for many other tax benefits (e.g., child credit, education credits, adoption credit, Making Work Pay credit, ability to contribute to a deductible IRA, etc) . However, “**itemized**” deductions (i.e., below-the-line deductions) do **not** reduce your “adjusted gross income” and, therefore, will not affect your 2010 deductions and credits that are reduced as your income increases. *Itemized deductions* generally include charitable contributions, state and local income and property taxes, medical expenses, unreimbursed employee travel expenses, and home mortgage interest. **Tax Tip.** “Payment” typically occurs in 2010 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, Discovery, American Express) in 2010. **Be careful**, if you post-date the check to 2011 or if your check is rejected, no payment has been made in 2010. **Planning Alert!** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment will not be deductible in 2010.

Accelerating “Itemized” Deductions Into 2010 May Be Particularly Valuable For Higher Income Taxpayers. If your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years. **Higher-Income Taxpayers.** Until 2009, itemized deductions for higher-income taxpayers began phasing out once their AGI reached a certain threshold. For **2010 only**, all taxpayers are exempt from this phase-out. However the phase out is scheduled to return fully **in 2011**. Consequently, for 2010, all taxpayers (regardless of income) will generally receive the full “regular” income tax benefit of their itemized deductions. Thus, if you anticipate that your income will exceed the beginning phase-out threshold in 2011 (for both joint and single returns, the threshold will begin at \$169,550 **for 2011**), 2011 itemized deductions that are accelerated into 2010 will avoid the phase-out impact. **Tax Tip.** The easiest deductions to shift from 2011 to 2010 are *charitable contributions, state and local taxes*, and your January, 2011 home *mortgage interest payment*. For 2010, the standard deduction is \$11,400 on a joint return and \$5,700 for single individuals. If you are blind or age 65, you get an additional standard deduction of \$1,100 if you're married (\$1,400 if single). **Watch Out For AMT!** Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes and unreimbursed employee business expenses. Before you accelerate 2011 itemized deductions into 2010, to be safe, we should first do a “with and without” computation so we can determine the AMT impact of this strategy. **Planning Alert!** If Congress fails to extend certain provisions that reduced the so-called *marriage penalty* that expire after 2010, the standard deduction for married taxpayers filing jointly is currently scheduled to drop from **\$11,400 for 2010**, to an estimated **\$9,650 for 2011**.

“Bunching” Medical Expenses. Many taxpayers ignore the medical expense deduction because medical expenses are deductible only if they exceed 7.5% of your AGI (10% for AMT purposes). However, if you have medical expenses that are discretionary, you may be able to “bunch” them into 2010 or 2011 and exceed the 7.5% floor. For example, braces are discretionary, and medical procedures such as laser eye surgery may be discretionary and qualify for the medical expense deduction. **Tax Tip.** You can include in your medical expenses the following: medical insurance premiums, transportation essential for medical care, lodging (but not meals) while away from home primarily for medical care, and changes to your house to accommodate a physical handicap. Tuition payments to a special school for a child with severe mental or physical disabilities (which would include medically diagnosed attention deficit hyperactivity disorder) may also qualify as a medical expense. However, the IRS requires that a doctor recommend that a child

attend the school, and the school generally must determine the portion of the tuition payment that relates directly to the medical needs of the child. Also, the costs of programs and prescription drugs to help people stop smoking qualify as a medical expense. **Planning Alert!** Under the *2010 Health Care Act*, **starting in 2013** (2017, if age 65 or older), medical expense will be allowed only if they **exceed 10%** (up from 7.5%) of your AGI.

Take Advantage Of Health Savings Accounts (HSAs). Health Savings Accounts (HSAs) have been one of the fastest-growing ways to save for health care. Qualifying contributions to health savings accounts (HSAs) are fully deductible whether or not you itemize deductions, and distributions for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). For 2010, if you have "family" coverage, your HDHP must have a minimum annual deductible of \$2,400 (\$1,200 for self only coverage). For 2010, your maximum contribution to an HSA is \$3,050 (\$4,050 if 55 or older) for self-only coverage, and \$6,150 (\$7,150 if 55 or older) for family coverage, even if your qualifying HDHP deductible is less. **Tax Tip.** Your contribution to your HSA reduces your AGI which, in turn, could free up other deductions and credits that phase out as your income exceeds certain thresholds. **Planning Alert!** As long as you are covered by a qualifying high deductible health plan by **December 1, 2010**, you will be able to contribute up to the maximum 2010 contribution limitation (e.g., \$6,150 for family coverage in 2010), subject to potential recapture rules.

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). Flex plans have a key deadline. For most *calendar-year* plans, you must clean out your 2010 account by March 15, 2011, or forfeit any funds that aren't used for qualifying expenses. **Planning Alert!** This March 15, 2011 deadline applies only to flex plans **that have been amended** to give participants 2½ months after year-end to use up current year contributions to the plan. If your calendar-year flex plan has not been amended, you must use up your account by **December 31, 2010 or forfeit the balance.** **Non-Prescription Drugs.** As a result of the recently-enacted *Health Care Act*, reimbursements for drugs and medicines will be tax free only for a prescribed drug or insulin, **effective for purchases after 2010.** **Tax Tip.** The IRS says that non-prescription drugs *purchased before 2011*, may be reimbursed tax free **after 2010.** If you have been using a tax-favored reimbursement arrangement to reimburse you for your *over-the-counter* medications (e.g., to treat a chronic medical problem such as allergies or asthma), you might want to stock up on these medicines **before 2011** (even if the reimbursement occurs after 2010). **Caution!** Starting in **2013**, the *Health Care Act* also places a \$2,500 annual cap on employer and/or employee contributions to *health care spending arrangements* (FSAs). Under current law, there is no annual limit (except as may be imposed by the plan itself).

Maximizing Employee Business Expenses. If you are incurring unreimbursed employee business expenses, you must reduce those expenses by 2% of your adjusted gross income (this limitation applies for **both 2010 and 2011**). "Bunching" these expenses into 2010 or 2011 so the 2% threshold is exceeded may reduce your taxes. You can bunch 2011 expenses into 2010 by prepaying the 2011 amounts in 2010. **Planning Alert!** Unreimbursed employee-business expenses are not deductible at all for purposes of computing your alternative minimum tax. **Tax Tip.** If you are a "statutory employee" (e.g., full-time life insurance salesperson, certain commissioned drivers, certain home workers) you are not subject to the 2% limitation for employee business expenses. The "statutory employee" box on your Form W-2 should be checked if you are classified as a statutory employee.

- **Taking Advantage Of Employer's "Accountable Plan."** As an employee, you can avoid the 2% reduction rule and the AMT exposure for employee business expenses, if you document your business expenses and get reimbursed by your employer under an "accountable plan." We can help you establish a proper reimbursement arrangement with your employer. **Planning Alert!** Employees should always formally seek reimbursement from their employers for legitimate employee business expenses, or obtain a representation from their employer that it will not reimburse such expenses. Otherwise, the employee business deduction may be disallowed altogether.
- **IRS Standard Mileage Rates For 2010.** The IRS "business standard mileage" reimbursement rate for

2010 is **50 cents-per-mile**. The rate for “medical and moving” expenses is **16.5 cents-per-mile**, and for “charitable” contributions is **14 cents-per-mile**.

Home Office Deduction. Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) may be easier than you think. If you're self-employed, you only have to establish that you use your home office "regularly and exclusively" to perform management or administrative duties for your business and that there is no other fixed location where you perform substantial management or administrative duties relating to that trade or business. If you are an employee, in addition to meeting the previous requirements, you must also establish that your home office is "for the convenience of your employer" (this generally means you're not provided an office at work). **Tax Tip.** The IRS says that if you have a qualifying home office, you can deduct any travel from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement should be excluded from your income if reimbursed under an “accountable reimbursement arrangement.” If you are an employee and your home office expenses are not reimbursed, the home office expense deduction will be reduced by 2% of your adjusted gross income and will not be deductible at all, for purposes of the Alternative Minimum Tax.

Charitable Contributions. You may save taxes by following the year-end planning techniques for charitable contributions described below:

- **Be Sure To “Pay” Your Charitable Contribution In 2010.** A charitable contribution deduction is allowed for 2010 if the check is mailed **on or before December 31, 2010**, or the contribution is made by a credit card charge in 2010. However, if you give a note or a pledge to a charity, no deduction is allowed until you pay off the note or pledge.
- **Temporary Rule For Tax-Free IRA Payments To Charities Expired After 2009!** For the past several years, we have had a popular (but *temporary*) rule that allowed taxpayers who had reached age 70½, to contribute up to \$100,000 from their IRAs directly to a qualified charity, and exclude the distribution from income. **Planning Alert!** This provision **expired after 2009**, and is not available for 2010 unless Congress decides to extend it. If you are interested in this provision, please call our office and we will give you a status report.
- **Contributions Of Appreciated Property.** If you are considering a significant 2010 contribution to a public charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute appreciated long-term capital gain property, rather than selling the property and contributing the cash proceeds to charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation. **Planning Alert!** If you want to use “loss” stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, you will get the same charitable deduction (equal to the value of the contributed stock), but you will lose the capital loss deduction.
- **Substantiation Requirements.** If you contribute \$250 or more to a charity, you are allowed a deduction only if you receive a **qualifying written receipt** from the charity by the time your return is filed. **Planning Alert!** You must receive this receipt **before** we file your 2010 return, and you should retain the receipt in your tax files in case you are later audited. IRS says a canceled check is **not** sufficient where a receipt is required! Also, no deduction will be allowed for charitable contributions of clothing or household items, unless the items are in “good used condition or better.” **Tax Tip.** You should consider contributing your clothing and household items to charitable thrift shops that have a policy of accepting only items that are in good condition.
- **Contributions Made In Cash Or By Check.** In order to deduct a charitable contribution made in cash, by check, or by other monetary means, the contribution must be supported by **1)** a bank record (e.g., a

cancelled check), or **2)** a receipt, letter or other *written* communication **from the charity** showing the name of the donee organization, the date of the contribution, and the amount of the contribution. **Tax Tip.** Without these records, you are allowed no deduction at all, regardless of amount. Since a cancelled check satisfies these new requirements, you should consider replacing your cash contributions with a check. If you contribute by payroll deduction, IRS says that you will satisfy this requirement if you have a pay stub or W-2 setting forth the contribution amount and a pledge card prepared by the charity. **Planning Alert!** If the contribution is for \$250 or more, you will also need a written receipt that includes a statement indicating whether or not goods or services were received in return for the contribution.

- **Donations of Motor Vehicles, Boats, and Aircraft.** There are stringent reporting and documentation requirements for the donor and the charity that must be satisfied in order to claim a charitable deduction in excess of \$500 for a “qualified vehicle.” A “qualified vehicle” generally includes motor vehicles designed for highway use, boats, or airplanes. Generally, if you deduct more than \$500 for a “qualified vehicle,” your deduction is limited to the gross sales proceeds received by the charity on the sale of that vehicle. In addition to this deduction limitation, a deduction exceeding \$500 is not allowed at all unless you receive a Form 1098-C from the charity. **Tax Tip.** If your deduction is \$500 or less, your deduction is not limited to the sales price of the vehicle, and you are not required to file a Form 1098-C with your tax return. However, if your deduction is at least \$250, you must still obtain a qualifying written acknowledgment from the charity.

Maximizing Home Mortgage Interest Deduction. If you are looking to maximize your 2010 deductions, you can increase your home mortgage interest deduction by paying your January, 2011 payment **on or before December 31, 2010.** Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December. **Planning Alert!** Make sure that you send in your January, 2011 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender will be sure to reflect that last payment on your 2010 Form 1098, and we can avoid a matching problem on your 2010 return. Here are some other planning strategies you should consider:

- **Look For Deductible “Points.”** Points paid in connection with the purchase or improvement of your principal residence are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include “loan-processing fees,” “loan premium charges,” or “loan origination fees” so long as they don’t represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys’ fees, credit checks, property taxes, or mortgage insurance premiums). **Tax Tip.** If 2010 marks at least the second time that you refinanced your home, and you are not refinancing with the same lender, you may deduct in 2010 the unamortized points from the previous refinancing.
- **Remember To Deduct Seller-Paid Points.** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.
- **Pay Off Personal Loans First.** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

Time Payment Of State And Local Taxes To Your Benefit. If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2010) and any property taxes for 2010 **prior to January 1, 2011** if your tax rate for 2010 is higher than or the same as your projected 2011 tax rate. This will allow a deduction for 2010 (a year early) and possibly against income taxed at a higher rate. **Planning Alert!** State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, “overpayment” of your 2010 state and local income taxes is generally not advisable particularly if a refund in 2011 from a 2010 overpayment will be taxed at a higher rate than the 2010 deduction rate. **Please consult us before you overpay state or local income taxes!**

- **Temporary Rule For Deducting Sales Tax Expired After 2009!** For the past several years, we have

had a *temporary* rule that allowed taxpayers to “elect” to deduct “either” state and local *income* taxes or state and local *sales* taxes, as itemized deductions. This election has been particularly popular among residents who live in states with little or no state income taxes, or states where the state income tax rate is generally lower than the sales tax. **Planning Alert!** This provision **expired after 2009**, and is not available for 2010 unless Congress decides to extend it. If you are interested in this provision, please call our office and we will give you a status report.

- **Temporary Real Property Tax Deduction For Non-Itemizers Expired After 2009!** For **2008 and 2009**, if you do not itemize your deductions (i.e., you take the standard deduction), you were allowed to claim an *additional* “standard deduction” for any state and local property taxes you paid (limited to \$500 if single, \$1,000 in the case of a joint return). **Planning Alert!** This provision **expired after 2009**, and is not available for 2010 unless Congress decides to extend it. If you are interested in this provision, please call our office and we will give you a status report.

Planning With Education Costs

During these trying economic times, more workers have either been laid off or their hours and pay have been cut. If you find yourself in this situation, it may be a good time to explore educational opportunities that will enhance your marketability. To encourage higher education, our Tax Code provides a long list of deductions and credits that can be particularly helpful, including: the “American Opportunity Credit” the lifetime learning credit, student loan interest deductions, and others. As you develop your 2010 tax year-end planning strategies, the following should help you navigate these interrelated (and sometimes overlapping) education tax incentives:

- **“American Opportunity Education Tax Credit” (Formerly “Hope Credit”).** Before 2009, individuals were allowed a HOPE tuition tax credit (HOPE Credit) for qualifying tuition costs generally for the first two years of college (e.g., freshman and sophomore years). **For 2009 and 2010**, Congress changed the name of the HOPE credit to the **“American Opportunity Tax Credit”** and increased the maximum credit from \$1,800 to \$2,500 (100% of the 1st \$2,000 of qualifying education expenses plus 25% of the next \$2,000 of qualifying expenses); increased the total number of years that a student may qualify from *two* years to *four* years (i.e., generally, freshman through senior years); increased the income phase-out levels (for 2010 the credit is phased out as your modified adjusted gross income increases **from \$160,000 to \$180,000 for those filing joint returns** and **from \$80,000 to \$90,000 for single filers**); made 40% of the credit refundable (*unless the person claiming the credit* is subject to the so-called *kiddie tax rules*); and added *course materials* to the expenses (in addition to tuition and fees) that qualify for the credit. **Planning Alert!** This credit will automatically revert to its **pre-2009** provisions **after 2010**, unless Congress decides to extend it. To get the full \$2,500 credit for 2010, you must pay qualifying expenses of at least \$4,000 for the student **by December 31, 2010**. For example, if you paid tuition and books of \$2,500 for the fall, 2010 semester for a college freshman, you would need to pay tuition of at least \$1,500 for the spring, 2011 semester by **December 31, 2010**, to get the full credit of \$2,500 for 2010.
- **The Lifetime Learning Credit.** The *Lifetime Learning tax credit* equals 20% of the first \$10,000 of qualified higher education tuition and fees. The credit phases out ratably as your modified adjusted gross income increases from **\$100,000 to \$120,000** on a joint return (**\$50,000 to \$60,000** on a single return). Unlike the American Opportunity Tax Credit (discussed above), the Lifetime Learning credit is for an unlimited number of years and can be used for graduate or professional degrees (as well as undergraduate education). However, the Lifetime Learning credit **limitation of \$2,000 is per tax return, not per student**. **Planning Alert!** If your income **is more than \$120,000 (\$60,000 on a single return)**, you do not qualify for the Lifetime Learning credit. However, the IRS says the student (e.g., your child) may claim the credit on his or her return, provided you elect not to claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent). Of course, since the Lifetime Learning credit is a *non-refundable* credit, your child must have sufficient income tax liability to utilize the credits on his or her return.
- **Temporary Tuition Deduction Expired After 2009!** For the past several years, we have had a *temporary* rule that allowed taxpayers who were below certain income thresholds, to deduct *qualified*

higher education tuition and fees. **Planning Alert!** This provision **expired after 2009**, and is not available for 2010 unless Congress decides to extend it. If you are interested in this provision, please call our office and we will give you a status report.

- **Student Loan Interest.** For **2010**, you may deduct (whether or not you itemized deductions) up to \$2,500 of interest on qualified student loans. Your deduction phases out as your adjusted gross income increases from **\$120,000 to \$150,000 on a joint return (from \$60,000 to \$75,000 on a single return)**. The IRS says that if a family member pays your interest, the payment will be treated as a gift to you, and you will then be treated as paying the interest yourself. **Planning Alert!** Without a Congressional “fix,” this deduction will become more restricted and the income phase-out thresholds will be much lower **after 2010**.
- **Using IRA Funds For Education Expenses.** If you have an IRA, you can withdraw funds for qualified higher education expenses without having to pay the normal 10% early distribution penalty. The distribution is, however, still taxable. **Tax Tip.** The distribution for higher education expenses, although taxable, may generate an American Opportunity Tax credit or a Lifetime Learning credit. Also, this exception from the early distribution penalty for qualifying education expenses only applies to *distributions from IRAs*. Therefore, if you receive a distribution from your *employer’s retirement plan* and you do not meet any other exception to the 10% penalty, you will generally pay the 10% penalty tax even if you use the funds for qualifying education expenses. Consequently, a distribution from your employer’s retirement plan **should be first rolled to an IRA** within the 60-day rollover period, and then distributed from the IRA for qualifying education expenses to avoid the 10% penalty. **Planning Alert!** You must withdraw the funds *in the same tax year* that you pay the qualified education expenses to avoid the 10% early distribution penalty. Therefore, if you have paid qualifying education expenses in 2010 and want a penalty-free reimbursement from your IRA, you must **make the distribution no later than December 31, 2010**.

Planning With Retirement Plans

Consider Contributing Maximum Toward Your Retirement. As your income rises and your marginal tax rate increases, deductible retirement plan contributions generally become more valuable to you. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute, consider the following:

- **IRA Contributions.** If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to \$10,000 (\$12,000 if you’re both at least age 50 by the end of the year) for contributions to your and your spouse’s traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than \$5,000 (\$6,000 if you’re at least age 50) may be contributed to either your or your spouse’s separate IRA for 2010. If you are an active participant in your employer’s retirement plan during 2010, your IRA deduction is phased out ratably as your adjusted gross income increases from **\$89,000 to \$109,000** on a joint return (**\$56,000 to \$66,000** on a single return). However, if your spouse is an active participant in his or her employer’s plan and you are not an active participant in a plan, your ability to contribute the full amount to an IRA phases out only as the adjusted gross income on your joint return goes from **\$167,000 to \$177,000**. **Planning Alert!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2010, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **\$167,000 to \$177,000** on a joint return or from **\$105,000 to \$120,000** if you are single.
- **Workers At Least Age 70½.** If you are age 70½ or older, you **cannot** make a contribution to a traditional IRA. **Tax Tip.** If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½.
- **Consider Contributing To Your Company’s §401(k) Plan.** If you are covered by your company’s §401(k) plan, you should consider putting as much of your compensation into the plan as allowable.

The maximum contribution you may make (employee portion) for 2010 is \$16,500 (\$22,000 if you're at least age 50 by the end of 2010). This is particularly appealing if your employer offers to match your contributions.

- **Seek Advice Before Dipping Into Your Qualified Retirement Accounts Or IRAs!** If the recession is causing you financial distress which is tempting you to tap your retirement plan funds, **be extremely careful!** There are specific ways to withdraw funds without paying a 10% penalty (although you generally must include the withdrawal in your taxable income). For example, you can generally withdraw funds from your IRA without penalty if: **1)** you have reached age 59½, **2)** you have been medically determined to be disabled, **3)** you are using the funds for qualified education expenses, **4)** you are receiving unemployment benefits and you use the funds for medical insurance premiums, or **5)** you take substantially equal payments over your life expectancy. **Planning Alert!** These rules are exceedingly technical and if not properly followed, can result in a 10% penalty. Please call our firm if you need to access your retirement funds and we will help you determine if you qualify for one of these exceptions to the penalty.

MISCELLANEOUS YEAR-END TAX PLANNING OPPORTUNITIES

Don't Overlook Expanded Tax Credits For Making Energy-Efficient Improvements To Your Home.

Starting several years ago, Congress gave us several *nonrefundable* credits for making certain energy-efficient improvements to our homes, and for installing qualified solar panels and solar water heaters. Last year, the "American Recovery Tax Act of 2009" temporarily increased the amount of these credits, and for the first time allowed the credits to offset your alternative minimum tax. **Tax Tip.** Unlike many other tax benefits, these credits are not reduced or eliminated as your AGI increases. Therefore, you may qualify for these credits regardless of your income level. These credits include:

- **Up To \$1,500 Credit For Qualified Energy-Efficient Home Improvements.** For improvements to your *principal residence located in the U.S. and placed in service in 2009 or 2010*, the 2009 Act provides a 30% credit for qualified expenditures with a \$1,500 maximum *cumulative* credit for the 2009 and 2010 tax years (previously, there was a lifetime credit limit of \$500). Qualified improvements can include *properly certified* energy efficient roofs, insulation, exterior windows (including skylights), exterior doors, heat pumps, hot water boilers and air conditioners. **Tax Tip.** Before making energy-efficient improvements to your home, you should first check to see if the manufacturer has certified the products as qualifying for the energy tax credit. **Planning Alert!** This provision **expires after 2010**, unless Congress decides to extend it. To take the credit for 2010, the qualifying property must *actually be installed no later than December 31, 2010*.
- **30% Credit For Qualified Residential Solar Water Heaters, Geothermal Heat Pumps, Wind Energy Property, And Solar Electric Generating Property.** If you install a qualifying solar water heater, solar electric generating property, geothermal heat pump, or small wind energy property in or on your residential property located in the U.S., you may qualify for a credit equal to 30% of the equipment's cost (including onsite labor costs). The residence does **not** have to be your "**principal residence**," so installations in your second residence or vacation home may qualify. **Tax Tip.** The IRS says on its website that this credit is available to the extent that the purchase price of a new home can be reasonably allocated to the qualifying energy-efficient equipment. Therefore, if you purchased a new home in 2010, be sure to ask the builder to provide you a cost breakdown of any solar electric panels, solar water heaters, etc. **Planning Alert!** Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify. Also, to take the credit for 2010, the property must *actually be installed no later than December 31, 2010*. **Please note** that this credit is not currently scheduled to expire until **after 2016**.

Planning With The "Kiddie Tax." A child who *is not filing a joint return with a spouse* will have his or her unearned income (e.g., interest, dividends, and capital gains) in excess of the *threshold amount* (\$1,900 for 2010), taxed at the *parents' tax rate* if: **1)** The child **has not attained age 18** by the *close of the tax year*, **OR 2)** The child **is age 18** by the *close of the tax year* **AND** the child's **earned income does not exceed one-half the child's support**; **OR 3)** The child is **age 19 through 23** by the *close of the tax year* **AND** the child is a full-time student **AND** the child's earned income does not exceed one-half the child's

support. **Planning Alert!** College students subject to the *kiddie tax* sell off their appreciated capital gain property (for example to cover tuition), and pay tax at the student's lower tax rates. Furthermore, most college students under age 24 will generally be unable to qualify for the zero percent capital gains tax rate discussed previously. **Tax Tip.** Since a child's *earned income* is not taxed at the parents' rate, you should consider employing your child in your business and paying your child *reasonable* compensation. Your child's earnings won't be subject to the kiddie tax and will generate a deduction for the family business. Also, if your child is over age 17 and generates earned income exceeding one-half of his or her support, the child could also avoid the kiddie tax exposure for his or her unearned income.

Estate, Gift, And Generation-Skipping Taxes. If someone died in 2009, generally, \$3.5 million of asset value in the estate was exempted from the estate tax. **For 2010**, the federal estate tax is repealed. The estate tax is scheduled to be reinstated in 2011 with only \$1,000,000 of asset value exempt from the tax. However, President Obama has recommended that the exemption should be reinstated at the 2009 exemption level of \$3.5 million. Bills have also been introduced in Congress proposing even higher exemption amounts. But, nobody knows for sure what will happen. In addition, the exemption from the generation-skipping tax was \$3.5 million for 2009. However, there is no generation-skipping tax for 2010. But, the generation-skipping tax is scheduled to return in 2011 with a \$1,000,000 exemption (indexed for inflation). Therefore, individuals wishing to make transfers to their grandchildren or great grandchildren, should consider making those gifts in 2010 while there is no generation-skipping tax. **Caution!** It is possible, although more and more unlikely, that Congress may reinstate the estate and generation-skipping taxes retroactively. Therefore, before making any transfers, you should consult your estate planning advisor.

Caution! Beneficiaries who receive property from a decedent **who dies in 2010** will "generally" obtain an income tax basis equal to the decedent's tax basis immediately preceding his or her death (i.e., beneficiaries will generally **not** receive a tax basis equal to the "value" of the property at the decedent's death as has traditionally been the case). However, certain appreciated property may receive an increase in basis on the decedent's death of up to \$1.3 million (plus there is an additional \$3 million basis increase for certain appreciated property passing to a surviving spouse). In addition, executors of estates must file a form with the IRS and with the heirs of the estate receiving property from the estate, where the value of the property in the estate, less any cash, is more than \$1.3 million. The penalty for failing to file this form is \$10,000 unless there is reasonable cause for failing to file the form. The form is not yet available.

Note! The gift tax has not been repealed. Tax Tip. You can still reduce your estate by making annual gifts using the annual gift tax exclusion of \$13,000 per donee. Your spouse can do the same, bringing the total to \$26,000 per donee. **Planning Alert!** If you make your 2010 gift by check, the IRS says that the donee must actually "deposit" the check **by December 31, 2010** in order to utilize the 2010 \$13,000 annual gift tax exclusion.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. Please call us before implementing any planning ideas discussed in this document, or if you need additional information. **Note:** The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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