

October 30, 2009

To Our Clients and Friends:

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

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

Regardless of the approach taken, it is important to limit tax planning to achieving your financial goals in a tax efficient manner. You never want to simply minimize your tax liability without regard to the impact on your net worth. In addition, you should look at your tax situation for *at least* a two-year period, with the objective of reducing your tax liability for the two years combined rather than just for 2009.

Watch out for AMT. It is vital that you stay alert for the impact of the Alternative Minimum Tax (AMT). Individuals must compute their income tax liability under two systems—the regular tax system and the AMT system—and pay the higher of the two amounts. When introduced many years ago, the AMT targeted and normally only applied to high-income taxpayers who, in Congress' opinion, benefited too much from certain tax breaks. Today, however, virtually no taxpayer can ignore the AMT. Therefore, when tax planning, you must assess your exposure to both systems simultaneously. This is worse than it sounds, because tax planning for AMT is frequently counterintuitive, relative to regular tax planning.

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

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

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Ideas for Increasing Deductions

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

Make Charitable Gifts of Appreciated Stock. If you have appreciated stock (yes, there is still some of that out there...) that you have held more than a year and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You will avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no load mutual funds because there are minimal transaction fees involved.)

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

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

For instance, you might consider moving charitable donations you normally would make in early 2010 to the end of 2009. If you are temporarily short on cash, charge the contribution to a credit card—it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or state income taxes otherwise due in early 2010. However, these taxes are not deductible for AMT purposes, so this is another example of how planning simultaneously for both tax systems is critical.

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

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

- The optional itemized deduction for state and local sales and use taxes (in lieu of deducting state income taxes) will expire at the end of this year unless Congress takes further action. Therefore, if you live in a state with low or no state income tax and plan on making big-ticket purchases (such as a car, boat, or motorcycle, or airplane) in the near future, you may want to go ahead and make the purchase this year to cash in on the expiring sales tax break for 2009. There is no AGI based limit for this deduction, but you have to itemize to benefit and it is not allowed for AMT.
- If you live in a state with high state income taxes and plan on deducting state income taxes instead of state sales taxes this year, legislation passed earlier this year created a one-year federal income tax deduction that might interest you.

- For 2009, you can deduct state and local sales and excise taxes on purchases of new (not used) passenger autos, pickups, and SUVs, as well as motorcycles and RVs made between 2/17/09 and 12/31/09.
- The write-off is limited to the amount of taxes on the first \$49,500 of purchase price. You can claim the break whether you itemize or not, and it is allowed even if you owe AMT. However, a phase-out rule can reduce or completely eliminate the break if your AGI exceeds \$250,000 (\$125,000 if you are single).

Ideas for Investments

Harvest Capital Losses. If you are sitting on some investments that have dropped in value since you acquired them, now might be a good time to dump part or all of them to cut your tax bill. You can deduct capital losses up to the amount of any capital gains that you will have for the year (for example, from mutual fund distributions or sales of stocks or bonds). Also, you can claim up to an additional \$3,000 of losses (\$1,500 if you are married but filing a separate return) against your other income. Any losses in excess of these amounts carry over to next year.

If you are selling less than your entire interest in an investment, you can maximize the amount of deductible loss that you realize by telling your broker or mutual fund company to sell the highest basis shares first (and then have them confirm your instructions in writing within a reasonable time after the sale). In addition, if you think your investments that are currently underwater are poised for a comeback, you can buy them back after taking a loss as long as you do not reacquire them within 30 days before *or* after the sale. However, once again keep your net worth in mind. With volatility returning to the stock markets, planning to sit out for 30 days could turn out to be a bad move (if your stock were to increase significantly in value during the 30 day period).

Take Advantage of 0% Capital Gains Rate before It Is Too Late. For 2009, the federal income tax rate on long-term capital gains and qualified dividends is 0% when they fall within the 10% or 15% regular federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed \$67,900 if you are married and file jointly (\$33,950 if you are single). This 0% rate will likely continue to apply in 2010, but is scheduled for repeal in 2011.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who can. If so, consider giving them some appreciated stock or mutual fund shares, which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period is over a year. Giving away stocks that pay dividends is another tax-smart idea. As long as the gift recipient is in the 0% or 15% regular tax rate bracket, the dividends will be federal-income-tax-free.

Watch out though, if during 2009 you give away assets worth over \$13,000 to an individual gift recipient, the excess will generally eat into your \$1 million lifetime federal gift tax exemption and your \$3.5 million federal estate tax exemption. However, you and your spouse can together give away up to \$26,000 per recipient without any adverse effects on your respective gift and estate tax exemptions. Also, if you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting investment income to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions.

Secure a Deduction for Nearly Worthless Securities. If the dismal economy has left you with securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless.

Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier to just sell the security if it has any marketable value.

As long as the sale is not to a close family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

Ideas for Your Business

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

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

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

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

Ideas for the Office

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it is just about time to tell your company how much you want to set aside on a tax-free basis for next year.

Contribute as much as you can stand, especially if your employer makes matching contributions.

You give up “free money” when you fail to participate to the max for the match. If your company has a ROTH 401(k) option, you should consider using it instead of the regular 401(k) option. While you give up current tax benefits, you may gain greater long-term benefits. Again, maximizing your net worth is the ultimate goal.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has an FSA, during the annual enrollment period you must specify how much of your 2010 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying child care costs. Watch out, though, FSAs are “use-it-or-lose-it” accounts—you do not want to set aside too much more than what you will likely have in qualifying expenses for the year. Some people think it is a disaster to overfund even a single dollar. That is not the case. Remember that at a 33% tax rate, you will lose \$1 to taxes for every \$2 you have in medical expenses that you fail to set aside in your FSA. That is, if you fail to put \$2 into your FSA, you would have to earn \$3 and pay \$1 in taxes in order to have \$2 left to spend after-tax on medical expenses. Thus, at a 33% marginal rate, being \$2 short on contributions is just as bad as being \$1 overfunded. Either way you would lose \$1.

Adjust Your Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2009, consider bumping up the Federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will still have to pay any taxes due less the amount paid in. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your estimated 2009 liability or, if smaller, 100% of your 2008 liability (110% if your 2008 adjusted gross income exceeded \$150,000; \$75,000 for married individuals who filed separate returns), interest and penalties will be minimized, if not eliminated. We can run tax projections to help with this decision.

Ideas for Seniors Age 70½ or Older

Make Charitable Donations Directly from Your IRAs. If you have reached age 70½, you can arrange to transfer up to \$100,000 of otherwise taxable IRA money to the public charity of your choice (such as your church or other favorite charity). The distribution is federally income tax free. You do not get to claim it as an itemized deduction on your Form 1040. However, the tax-free treatment equates to a 100% write-off, and you do not have to itemize your deductions to obtain the benefit. Additionally, since it is tax-free, and thus does not factor into your AGI calculation, it may reduce your Social Security benefits subject to tax. Be careful though—to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity (you cannot receive cash and then donate it). Also, this provision expires at the end of 2009 unless Congress extends it. So, this could be your last chance.

Do Not Take Your Minimum Required Distribution for 2009. The tax laws generally require individuals with retirement accounts to take withdrawals based on the size of their account and their age every year after they reach age 70½. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. However, a temporary tax law change made in late 2008, waives the minimum distribution requirement for 2009. This means you can leave the amounts in your account without suffering the 50% penalty. This waiver applies to IRAs and defined-contribution plans, including distributions from 401(k), 403(b), and state-sponsored 457(b) accounts and is available to everyone regardless of their total retirement account balances.

Bottom Line: If you have not already received your required distribution during 2009 and you do not need the funds, you can just leave them in your retirement account for another year.

If you have already received the distribution and now wish you had not, you may be able to roll the funds back into your retirement account, even if the normal 60-day rollover period has already expired. However, this may require action before 11/30/09. If this situation applies to you, please give us a call.

Environmentally Friendly Ideas

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

Purchase a Qualifying Hybrid or Lean Burn Technology Vehicle If you have been considering purchasing a new hybrid or lean-burn technology vehicle, now may be a good time to do so. First of all, as we discussed earlier, the sales tax paid on the vehicle may be deductible. Second, purchasing a qualifying new (not used) vehicle this year may reap you an alternative motor vehicle tax credit from around \$900 to \$3,000, depending on the vehicle, which in 2009 can offset the AMT.

However, not all 2009 purchases qualify as credits are phased out once the manufacturer has sold over 60,000 qualifying vehicles. Because of this rule, no credits are allowed for 2009 purchases of Toyota, Lexus, and Honda hybrids and only reduced credits are available for Ford and Mercury hybrids. So far, full credits are still allowed for hybrids made by Chrysler, GM, Mazda, and Nissan. Full credits are also allowed for lean-burn technology vehicles made by Mercedes, Volkswagen, BMW, and Audi. Give us a call if you want to know the available credit amount for a specific hybrid or lean-burn technology vehicle.

Ideas for Your Estate

The federal estate tax exemption for 2009 is \$3.5 million. For 2010, the federal estate tax is supposed to be repealed—but just for that one year. It now seems clear that if the promised repeal ever happens at all, it will just be for 2010. The more likely scenario is that we will continue to have a federal estate tax for 2010 and beyond with a \$3.5 million or somewhat larger exemption. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan.

Make Annual Gifts to Reduce Your Estate. Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you and your spouse both can give each of them up to \$13,000 this year. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So the sooner you start an annual gifting program, the greater your aggregate benefit.

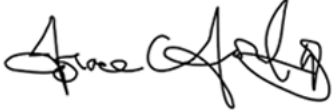
Capitalize on Depressed Security Values to Boost Giving Power. The current depressed security values may mean that more assets can be transferred within the limits of the gift tax annual exclusion amount (\$13,000 for 2009) and the lifetime applicable exclusion amount (\$1 million). Thus, if a security's value is expected to participate in the inevitable (we hope) economic recovery (and especially if the security is expected to significantly appreciate) this may be the perfect time to give the security to the intended recipients. However, *do not* give away loser shares (currently worth less than what you paid for them). Instead, sell the shares, and take advantage of the resulting capital loss, and then give away the cash.

Conclusion

With a little effort and some careful planning, it is possible your 2009 & 2010 tax liabilities can still be significantly reduced. We are available to assist you with the planning process in any way we can. Please do not hesitate to contact us with questions or ideas on reducing your tax bill.

Very truly yours,

GORDON & ASSOCIATES, P.A., CPAs

A handwritten signature in black ink, appearing to read "Horace C. Gordon, IV". The signature is fluid and cursive, with a large, stylized initial "H" and "G".

Horace C. Gordon, IV, CPA/PFS, CFP*