



## **Year End Planning for 2009: Tax Strategies** **By David R. Stafseth, CPA**

As 2009 nears its end, it is time to review your personal income tax situation and consider your available options for tax savings or tax deferral. There have been a significant number of tax changes in the last few years, and 2009 is no exception. In order to stimulate the economy, Congress has passed a number of tax breaks to assist in the recovery. Now is an excellent time to consider the impact of these changes on your personal tax return.

### **For Starters:**

An important element in 2009 tax planning is to consider your estimated income and deductions for 2010 as well as the current year. Comparing your expected income in 2009 to your projection for 2010 may provide you with a number of different strategies. Is your tax bracket higher in one year versus the other? Should you accelerate or defer income or expenses? Are you likely to be subject to the alternative minimum tax in one or both years? Are you able to “bunch” certain deductions in one year, especially where an income limitation applies?

This focus on both 2009 and 2010 will also allow you to consider the tax effects of realizing income prior to 2011, which is generally considered the likely effective date for potential tax increases presently being debated by Congress.

### **Individual Deduction Opportunities:**

Some simple items to keep in mind when planning for your personal deductions:

1. Deductions on your individual return are deductible in the year actually paid.
2. Even if a check isn't cashed, it's still eligible as a 2009 deduction if dated and mailed before January 1, 2010.
3. If you pay for deduction-eligible expenses on a credit card prior to year-end, you may include them on your 2009 return, even if you don't pay the credit card bill until 2010.

### **Medical Expenses**

Medical expenses, including insurance premiums, are deductible only to the extent they exceed 7.5% of adjusted gross income (AGI). An even larger hurdle of 10% applies if a taxpayer is subject to the alternative minimum tax (AMT). To combat this, try to accumulate expenses in one year, especially in a lower income year.

Carefully consider your available opportunities to pay for medical expenses with pre-tax dollars by participating in employer plans such as Health Savings Accounts and Flexible Spending Accounts.

### **State Taxes**

If you expect to have a state tax balance due, or plan on making a 4<sup>th</sup> quarter estimated state tax payment, or have 2010 property tax payment due, consider making one or all of the payments during 2009 to receive added deduction. However, if you're expecting to be subject to AMT, defer the payments to 2010 since you'll receive no benefit from paying them early.

### **Charitable Contributions**

Keep in mind that charitable cash contributions now require a record of the contribution in the form of a canceled check, a bank copy of a canceled check, a bank statement identifying the name of the charity, the date and amount of the contribution, or a written communication from the charity containing the date and

amount of the contribution. Contributions of \$250 or more must be evidenced by a required statement or letter from the charitable organization.

To maximize your tax benefit, consider gifting shares of appreciated securities to a charitable organization. The deductible amount is measured by the fair market value of the security on the day of transfer, not your cost basis in the investment. By gifting appreciated stock, you may deduct the full value while avoiding the capital gains tax on the appreciation. In the case where your cost exceeds the value, it would be preferable to sell the investment and recognize a capital loss; then donate the cash proceeds to the organization.

Individuals aged 70 ½ or higher may once again contribute up to \$100,000 to a charitable organization directly from a Traditional or Roth IRA during 2009. This provision is scheduled to expire at the end of the year and generally benefits individuals who would otherwise be subject to a percentage limitation on their deduction for charitable contributions.

### **Business Deduction Opportunities:**

Several opportunities exist for businesses (whether self-employed or otherwise operated through a business entity) to take advantage of liberalized deductions:

#### Equipment Purchases

The Section 179 election allows businesses to expense upfront a sizeable amount of equipment purchases that would otherwise be depreciated over a number of years. For 2009, the maximum Section 179 expense is \$250,000, which is reduced dollar for dollar if total qualified additions exceed \$800,000. In 2010, the maximum expense decreases to \$125,000 and is phased out for additions above \$500,000. As in prior years, business income cannot be reduced below zero.

For qualifying property acquired and put to use before the end of 2009, businesses may also be eligible to claim the special 50% bonus depreciation, which is computed after any Section 179 expense and is in addition to regular depreciation. The original use of the property must begin with the taxpayer, so used equipment purchases do not qualify.

#### Net Operating Loss (NOL) Carry back

Under recent legislation signed into law by President Obama, business loss carry back provisions have been expanded for 2008 and 2009 losses. Previously (under earlier 2009 legislation), only eligible small businesses were allowed to carry back losses from 2008 for three, four or five years rather than two years. Now all businesses are permitted to carry back either a 2008 or 2009 loss for up to five years; however, a 50% income limit applies to any loss used in the fifth previous year. Eligible small businesses with average receipts of \$15 million or less, including individual sole proprietors, can elect the expanded carry back option for losses in both 2008 and 2009.

### **Help from Retirement Plans:**

IRAs and other retirement plans are an excellent way to reduce the size of your tax bill as well as save for your retirement. New or changing rules relating to retirement plans for 2009 include:

#### Traditional IRA Contribution Limits

Individuals who are not active participants in an employer-provided retirement plan may be eligible to contribute to a traditional IRA. For 2009, the maximum contribution is \$5,000. Further, individuals aged 50 or over may add an additional catch-up contribution of \$1,000. IRA contributions must be made by April 15, 2010, to be eligible as a 2009 deduction.

Individuals who are active participants in an employer-provided retirement plan, such as a 401(k), may also be able to contribute to a traditional IRA subject to Adjusted Gross Income (AGI) limits. Phasing out of the deduction begins for single taxpayers at \$55,000 and for married filing jointly taxpayers at \$89,000. The deduction is completely eliminated at AGIs of \$65,000 and \$109,000, respectively.

If your spouse also contributes to an IRA, your IRA contribution is limited to the lesser of \$5,000 (plus catch-up contribution if applicable) or the total of both spouses compensation reduced by the other spouse's IRA contribution. Simply, spouses may not contribute to their separate IRAs more than their combined earned income for the year.

#### 401(k) Contribution Limits

For 2009, the maximum contribution to a 401(k) plan is \$16,500. If you are age 50 or over, you can make an additional catch-up contribution of up to \$5,500 for 2009.

#### Required Minimum Distributions from IRAs

For owners of traditional IRAs who have reached age 70 ½, a minimum annual distribution is generally required. However, for 2009 only, this required distribution has been waived. If you reach age 70 ½ in 2009, you are not required to take a distribution by April 1, 2010.

#### Converting a Traditional IRA to a Roth IRA

Owners of traditional IRAs can convert all or a part of their accounts to a Roth IRA provided their 2009 modified adjusted gross income is less than \$100,000. Any amount converted is taxable income, but is thereafter eligible for the potential tax-free distribution rules of Roth IRAs. Starting in 2010, the \$100,000 income threshold is removed – anyone can do a conversion. For 2010 only, you also have the option to spread the income from conversion over the following two years (2011 and 2012). Many individuals and their advisors will be examining such decision factors as:

1. Tax rate projections (year of conversion vs. the withdrawal years)
2. Availability of outside funds to pay the income tax liability
3. Time horizon for growth of their IRAs

One unique situation may also exist for individuals who have a Net Operating Loss carrying into 2009 or 2010 from prior years. A conversion to a Roth IRA is one method to create taxable income which can be sheltered by the “tax benefit” from a Net Operating Loss deduction.

#### **New and Expanded Credits:**

##### HOPE and Lifetime Learning Credits

An enhanced HOPE Credit (renamed the American Opportunity Tax Credit) can be applied to qualified education expenses (tuition, fees, books, supplies) for the first four years of higher education (previously, the HOPE Credit only applied to the first two years). The maximum credit has increased to \$2,500, of which 40% is refundable. The credit begins to phase out at modified AGI levels of \$80,000 for single taxpayers and \$160,000 for married filing jointly taxpayers. Qualifying expenses must relate to a student who is considered to be attending school on at least a half-time basis.

The Lifetime Learning Credit continues to be a maximum of \$2,000 (20% of qualified expenses up to \$10,000). As opposed to the HOPE Credit, the student need not be attending school on at least a half-time basis. The only requirement is that the student be taking post-secondary classes to acquire or improve job skills. The credit begins to phase out at modified AGI levels of \$50,000 for single taxpayers and \$100,000 for married filing jointly taxpayers.

##### Homebuyer Tax Credits

The first-time homebuyer credit has been much publicized and was recently extended and expanded. An eligible taxpayer may claim a one-time, refundable tax credit equal to the lesser of \$8,000 or 10% of the home's purchase price. As extended by recent legislation, the credit is available on a principal residence purchased during 2009 and through April 30, 2010 (including a binding contract by such date, with a closing by June 30, 2010). The credit is phased out at certain income limits, which are now higher for purchases after November 6, 2009.

This credit must generally be repaid if the home ceases to be the principal residence within 36 months of the purchase date. Certain exceptions to repayment apply, which include sale with no gain, incident to a divorce, transfer between spouses, or death.

For purchases after November 6, 2009 (and by April 30, 2010), a new credit of up to \$6,500 is available to certain homebuyers who replace their principal residence. They must have lived in the same principal residence for a five-year consecutive period during the eight years prior to purchase of the replacement home. No credit is allowed on a home purchase exceeding \$800,000, and income phase-outs begin at \$125,000 for singles and \$225,000 for joint filers.

#### Residential Energy Efficient Property Credit

Taxpayers that install select energy efficient property (photovoltaic, solar water heating, fuel cell property, wind energy property, and geothermal heat pumps) may be eligible for a credit. Except for fuel cell property, certain caps have been removed on the dollar limitations for 2009 costs associated with these properties.

#### Non-Business Energy Property Credit

This credit has been reinstated for 2009 and 2010, based on 30% of the cost of certain energy-efficient property or improvements you place in service. Included are high-efficiency heat pumps, air conditioners, and water heaters. Also qualifying are energy-efficient windows, doors, insulation materials, and certain roofs. The maximum credit per year is \$1,500.

#### **Capital Gains Planning:**

A review of your taxable investment portfolio is an important element of year end tax planning. If you have recognized net capital gains resulting from the year-to-date market recovery, you may want to take offsetting losses by selling some investments where you still have a paper loss. Alternatively, you may have unused capital losses from 2008, which are available to shelter capital gains you take during 2009. Depending on your situation and your investment portfolio, there may be a number of tax-effective options for you to consider before the end of December.

#### **Alternative Minimum Tax (AMT):**

Although updated legislation in 2009 will allow millions of taxpayers to avoid AMT, the alternative minimum tax should be reviewed and compared to regular tax for nearly all individuals doing year-end tax planning. In addition to increased exemption amounts for 2009 (\$70,950 for married filing jointly and \$46,700 for singles), nonrefundable personal credits may now offset a taxpayer's regular and alternative minimum tax.

If you are likely subject to the AMT, certain of the foregoing tax treatments should be re-examined since certain deductions are not allowed or are subject to different limitations or definitions.

A final word of caution is to consider your individual state income tax and its effect on any of the deductions or planning ideas discussed above. With the continually changing landscape that is tax law, it is a good practice to be aware of the highlights of annual tax updates. For those in basic tax situations, the above list is a good starting point to cover the major tax changes for 2009. However, for those in more complex situations, there are undoubtedly many more issues that will affect your return and the related planning available. For a comprehensive review of your tax situation and the planning that can be done to prevent unnecessary tax liabilities, it is essential that you consult a seasoned tax professional.

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