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To Our Clients and Friends:

As we approach year-end, it's time to focus on some end of the year tax planning opportunities you should consider for 2009, as well as your future tax years. Especially since in relative terms, the federal income tax environment is favorable right now.

Some General Comments

First of all, the goal of year-end tax planning is to identify strategies that will allow you to pay the lowest overall taxes. One means of accomplishing this goal, if you expect your income to stay about the same over the next few years, is to postpone the timing of when taxable income must be reported, and to accelerate the timing of when expenses can be claimed as deductions. Another method is to trade taxable investment income for nontaxable revenue, such as municipal bond interest. (However, this second strategy only makes sense if the tax-free yield on the new investment is greater than the after-tax rate on the current one.) Still another potential move that certain taxpayers may be eligible to make is to convert ordinary income (taxed at rates up to 35%) into long-term capital gain income, which is subject to a tax rate of no greater than 15% (see below under "Ideas for Your Business" for an example of this tax planning method).

Regardless of the approach taken however, it's important to remember to incorporate income tax planning into your comprehensive financial plan, so that you don't lose sight of optimizing your overall financial condition. 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 the 2009 tax year.

"Beware of AMT"

It is also important to be on the alert for the Alternative Minimum Tax (AMT). Certain individuals must compute their income taxes 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 altogether. Therefore, the first step in tax planning is to assess your exposure to AMT. Tax planning for AMT is often dramatically different than planning for regular income taxes, in fact sometimes the logic is completely opposite.

Who is at the highest risk for AMT? Many taxpayers can fall into the AMT trap, 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's take a look at some specific tax planning ideas that apply to the vast majority of taxpayers. Remember to contact our office if you would like to discuss those that may be appropriate for you, or if you want to consider other tax-saving strategies.

Ideas for Increasing Deductions and Credits

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 that you've 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'll 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 no transaction fees involved.)

However, if the stock is now worth less than when you acquired it, sell the stock, take the capital 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 can't immediately buy it back, as this will trigger the "wash sale" rules, which means your loss won't be deductible, but instead will be added to the basis in the new shares.

Maximize the Benefit of the Standard Deduction. For the 2009 tax year, 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 every other year. This allows you to time your itemized deductions, so that they are high in one year and low in the next, since you can claim actual expenses in the year they are paid, 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're temporarily short on cash, you can also 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, remember to consider the effect of AMT, as these taxes are not deductible for AMT purposes.

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.) Also, 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 these types of expenses, by paying for them every other year, as appropriate.

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 taxes, and plan on making a big-ticket purchase (such as a car, boat, motorcycle, or airplane) in the near future, you may want to go ahead and make the purchase this year, in order to take advantage of the expiring sales tax break in 2009. There is no AGI based limit for this deduction, but you have to be eligible to itemize your deductions, in order to benefit, and it is not allowed for AMT purposes.
- 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 the purchase price and you can claim the tax deduction whether you itemize or not. It is also allowed even if you owe AMT. However, a phase-out rule can reduce or completely eliminate the deduction if your AGI exceeds $250,000, if married filing jointly ($125,000 if you are single).

First-Time Homebuyer's Credit. You may still be able to take advantage of a tax credit for homes purchased by November 30, 2009. This credit stipulates the following in order for it to be allowable:

- The Credit applies to the purchase of a home that closes after April 8, 2008, and before Dec. 1, 2009.
- The taxpayer must be a first-time homebuyer, meaning that he (or spouse, if married) had no present ownership interest in a principal residence in the U.S. during the 3-year period before the purchase of the home to which the credit applies.
- The home must be used as a taxpayer's principal residence for at least three years from the date of purchase.
- The credit is fully refundable, meaning the credit will be refunded to eligible taxpayers, even if they owe no taxes, or the credit is more than the taxes owed.

Regarding Investments

Harvest Capital Losses. If you are holding some investments, which have dropped in value since you acquired them, now might be a good time to dump part or all of them, in order to reduce your tax bill. You can deduct capital losses up to the amount of any capital gains you 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're married but filing a separate return) against your other (non-capital) income. Any losses in excess of these amounts carry over to next year.

If you're 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 don't reacquire them within 30 days before *or* after the sale.

Take Advantage of the 0% Capital Gains Tax 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're married and file jointly ($33,950 if 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, subject to the "Kiddie Tax" rules.

Watch out though, if during 2009 you give away assets worth over $13,000 to an individual gift recipient, the excess will reduce 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 tax rates, instead of at the gift recipient's lower tax rates. This could defeat the purpose of making the gift, so please contact us if you have questions.

Secure a Deduction for Nearly Worthless Securities. If the current 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 net 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).

Strategies for Your Business

Consider Paying a Dividend in 2009. If you're 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 and/or perhaps a child to whom you've given stock) have taxable income that is low enough there won't be any tax at all on this income, assuming Kiddie Tax doesn't come into play. However, this may very well change in the near future, therefore now may be a good time to convert some of your C corporation stock into cash, at a more manageable income tax cost.

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's 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 bumped-up 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 31st of this year. The 50% first-year bonus depreciation option will expire at year-end, unless Congress takes further action to extend this provision.

Avoid the Hobby Loss Rules. A lot of businesses that are just starting out, or have recently hit a bump in the road due to the dismal economy, may wind up showing a loss for the year. If you are in this predicament, the last thing you would want is for the IRS to argue that your business losses aren't deductible, because they consider the activity to be a "hobby" rather than a "trade or business". Surprisingly, the IRS has been fairly successful recently in making this argument. Therefore, if your business is expecting a loss this year, let us know if you would like to talk in order to make sure we do everything possible to maximize the tax benefit of your business loss.

Workplace Tactics

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's 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 afford, especially if your employer makes matching contributions.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has an FSA, before year-end 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" type accounts, so you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

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. This way when you file your 2009 tax return, even though you may still have to pay income taxes, 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.

Ideas for Individuals 70½+ Years Old

Make Charitable Donations Directly from Your IRAs. If you've 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 don't 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 don't have to itemize your deductions in order to get it. Additionally, since it is tax-free, it may reduce the amount of your Social Security benefits ordinarily subject to income taxes. Be careful though—to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity. Also, this provision expires at the end of 2009, unless Congress extends it, so this could be your last chance.

Don't Take Your Minimum Required Distribution for 2009 (Only). 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 (only). This means you can leave the amounts in your account without incurring the 50% penalty. This waiver applies to IRA's 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. Additionally, if for some reason you have already taken your RMD for the 2009 tax year, and now want to undo what has been done, you can request a tax free rollover for a "wrongly issued" RMD, up until 11/30/09.

Save Money and The Planet

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.

Purchase a Qualifying Hybrid or Lean Burning Technology Vehicle If you have been considering purchasing a new hybrid or lean-burning 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. Secondly, purchasing a qualifying new (not used) vehicle this year may reap you an alternative motor vehicle tax credit from between $900 to $3,000, depending on the vehicle, which in 2009 can offset the AMT. However, not all 2009 purchases qualify for the credit, since they are phased out once the manufacturer has sold over 60,000 units of the 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-burning technology vehicles made by Mercedes, Volkswagen, BMW, and Audi.

Estate Considerations

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 amount now being considered. Therefore, planning to minimize the federal estate tax should still be considered as part of your overall financial plan.

Make Annual Gifts to Reduce Your Estate. Reducing your estate by making annual gifts continues to be an (estate) tax-smart strategy for larger estates. If you have some favorite relatives, or unrelated persons, you and your spouse 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 better.

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 annual gift tax exclusion amount ($13,000 for 2009), and the lifetime applicable exclusion amount ($1 million). Thus, if you anticipate that a security's value is expected to improve in the inevitable economic recovery, it may be the perfect time to give the security to an intended recipient. However, d*o not* give away a loser security, but instead sell this type of investment, in order to take the income tax advantage of the resulting capital loss, and then give away the cash.

To Conclude

With a little effort and some careful planning, it is still possible to reduce your 2009 tax liability. We're available to assist you in this planning process, in any way that we can, so please don't hesitate to contact us with your questions or ideas for reducing your taxes. We can also estimate your current year income tax liability, based upon your year to date income and deductions, so let us know if you would like to schedule an appointment for this purpose. You can contact us using whatever method works best for you, including calling us, via email and also through our website at **www.wittenbergcpa.com**.

Best regards,

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