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clientalert
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## See the big picture

Some tax-cutting strategies make good financial sense. Other tax strategies are simply bad ideas, often because tax considerations are allowed to override basic economics.

Here's one example of the tax tail wagging the economic dog. Let's say that you run an unincorporated consulting business. You want some additional tax write-offs, so you decide to buy $10,000 of office furniture that you don't really need. If you're in the 28% tax bracket and you deduct the entire cost, this purchase will trim your tax bill by $2,800 (28% of $10,000). But even after the tax break, you'll still be out of pocket $7,200 ($10,000 minus $2,800) – and stuck with furniture that you don't really need.

There are other situations in which people often focus on tax considerations and ignore the bigger financial picture. For example:

- Someone increases the size of a home mortgage, solely to get a larger tax deduction for mortgage interest.
- A homeowner hesitates to pay off a mortgage, just to keep the interest deduction.
- Someone turns down extra income, because it might "push them into a higher tax bracket."
- An investor holds an appreciated asset indefinitely, solely to avoid paying the capital gains tax.

Tax-cutting strategies are usually part of a bigger financial picture. If you are planning any tax-related moves, we can help make sure that everything stays in focus. For assistance, give us a call. ♦

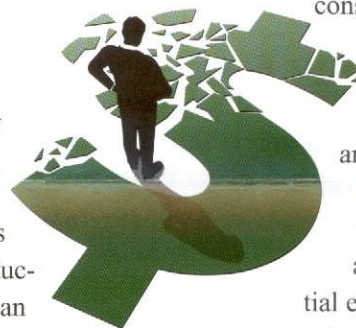
# Take five for a review of your tax and financial situation before year-end

As the end of another year approaches, take some time to review your tax and financial situation. There may be important moves you need to make before December 31.

Here are five year-end reminders to get your review started.

## 1. Tax breaks

Cut your 2009 tax bill by taking full advantage of tax breaks for which you could qualify. For example, there's the special property tax deduction for nonitemizers. You can deduct actual 2009 property taxes paid, up to a $500 limit if you're single and $1,000 if you're married filing a joint return.



Also available is the sales tax deduction on up to $49,500 of the purchase price of a new car, light truck, motorcycle, or motor home. Income limits apply.

If you're in business, take advantage of the 2009 first-year expensing limit of $250,000 for new or used equipment purchases. The 50% bonus depreciation is also available, but it applies to new equipment only.

## 2. Gifting

Seeing asset values decline over the past few years may have caused you considerable distress. One possible bright spot: You can give away more while valuations are lower. This strategy can reduce the total value of your estate and lower future potential estate taxes. You can make annual gifts in 2009 of up to $13,000 per recipient with no gift tax consequences. Just remember that 2009 gifts must be completed by December 31.

## 3. Tax payments

Review your 2009 withholding and estimated tax payments. If you have paid in too little, you could end

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up owing penalties plus the additional taxes.

The "making work pay" credit decreased the amount of tax being withheld from many taxpayers' paychecks. But if you hold down more than one job, have a spouse who also works, or are working while receiving social security benefits, you should review your withholding and if necessary adjust it before year-end.

If the majority of your income is from a small business, there is an added reason to check the taxes you've paid in so far this year. You may be able to use 90% of your 2008 tax liability as the safe harbor for your 2009 tax payments.

## 4. Retirement plans

If you're required to take annual distributions from your retirement plan, don't forget that these required minimum distributions (RMDs) were suspended for 2009.

Also, if you're aged 70½ or older, you can still donate up to $100,000 directly from an IRA to a charity without treating the donation as a taxable distribution.

## 5. Income management

Manage your income and deductions to keep from losing those tax breaks that phase out at higher income levels. If you would qualify for a particular deduction or credit, but your income for 2009 is right at the cut-off threshold, consider actions to reduce this year's income. Different income levels apply for the various credits and deductions, so some planning before year-end is advisable.

The moves you make, or fail to make, before the end of the year can have a major impact on your tax and financial situation. Contact our office soon for assistance with your review. ♦



# Coming change in Roth conversion rules creates planning opportunities

Under current rules, if a taxpayer's adjusted gross income (AGI) is greater than $100,000, no conversion from a traditional IRA to a Roth IRA is allowed. However, beginning in 2010, new conversion rules will end the $100,000 AGI limitation. In effect, any taxpayer at any income level and with any filing status will be able to convert all or part of a traditional IRA to a Roth IRA. Additionally, the tax attributable to such a conversion may be deferred until 2011 and 2012. This change allows for significant planning opportunities for many individuals.

Roth IRAs have two major advantages over traditional IRAs. First, qualified Roth IRA distributions are tax-free. The second advantage is that Roth IRAs are not subject to the required minimum distribution (RMD) rules that apply to traditional IRAs. The RMD rules generally require a taxpayer to begin taking distributions from his traditional IRA when reaching age 70½. Since the Roth IRA has no RMD rules, the funds can continue to grow tax-free until they are needed by the taxpayer, or are passed on (also income tax-free) to the taxpayer's heirs.

A conversion is considered a taxable distribution and will be taxed at ordinary rates. However, a conversion will not be subject to the 10% penalty for early distribution, regardless of age.

Congress has also sweetened the pot for conversions made in 2010 in that taxable income recognized on the conversion can be realized in full in 2010, or split over 2011 and 2012. This election to split the tax over two years is only available for 2010 conversions. And, if you do make this election, you will be subject to the tax rates in effect in 2011 and 2012.

**Look ahead to 2010**

Therefore 2010 is an important year for conversion for a number of reasons.

- Congress is expected to enact higher top-end tax rates for 2011 and later. Many higher-income taxpayers could find paying the tax on the conversion in 2010 at a lower rate to be preferable to a later conversion.
- Moderate-income individuals who are not subject to the increased top-end rates may find that the election to spread out the conversion income over two years is very tax friendly.
- Younger taxpayers who have a significant amount of time before reaching retirement age may find that generating tax-free income over a long period of time will more than recoup the dollars that were lost to taxes on the conversion.
- Older taxpayers, especially those in a higher tax bracket, will be able to avoid the taxes associated with RMDs from their traditional IRAs and could find that the overall tax impact is significantly less going forward…not to mention the ability to pass tax-free income to their heirs.

There are significant tax, estate, and financial considerations that might come into play. For an analysis of a Roth conversion in your situation, please call our office. ♦

# How to clear out the clutter and streamline your recordkeeping

Organizing your personal financial records need not be a difficult task, and it's sure to save you time and money in the long run. A well-organized system will help you retain important paperwork and reduce the clutter of keeping every scrap of paper. The first step in getting organized is deciding which records to keep and for how long. Use legal requirements and your common sense as guidelines for how long to hold on to records.

## Tax records

You should keep tax records for at least as long as it is possible for tax authorities to audit your return. Generally, the IRS has three years after the return is due or filed, whichever is later, to examine your return and assess additional tax. This is called the "statute of limitations." If you've made a major error on your return (defined as omitting more than 25% of your gross income), the IRS has six years to examine your return. There is no statute of limitation for fraudulent filing or for returns that are not filed at all. To be on the safe side, keep your tax records for seven years after a tax return is filed.

The IRS does not require that you keep your records in any particular way. The only requirement is that your records allow you and the IRS to determine your correct tax liability. Keep checks, receipts, and other records that document the income and deductions you report on your tax return. Copies of tax returns themselves should be retained permanently.

## Home

Expenditures for your home fall into two categories: "repairs" (such as routine yard maintenance and painting) and "improvements" (usually big-ticket items such as room additions).

Discard repair receipts once the warranty period expires, but keep receipts for improvements indefinitely. Improvements add to the tax basis of your property. Despite the $250,000 capital gain exclusion amount ($500,000 for joint filers), substantial increases in market value could make you liable for capital gains tax when you sell your home. Complete records of your home's original cost plus improvements will help reduce any taxes due.

## Investment real estate

Keep all documents relating to purchases of property, along with substantiation for improvements made to the property. Keep written appraisals and tax depreciation schedules.

## Investment records

Investment records generally should be kept until the investment is totally liquidated, plus a period of seven years. Keep any records for taxable accounts that show reinvested dividends. You can usually toss monthly or quarterly investment statements if you receive a comprehensive annual statement.

## Retirement accounts

Keep copies of Forms 5498, 8606, and 1099R until all money has been withdrawn from your IRAs. Good records are necessary so that you aren't taxed on nontaxable withdrawals.

## Insurance

Keep your current policies and 12 months' worth of cancelled checks and statements. Ask your insurance agent about discarding expired policies. Your liability for prior years can vary.

## Estate planning documents

In your home, keep a copy of your current will, any trusts, and any special directives. Give the originals to your attorney, and consult your attorney about destroying all out-of-date documents.

## Keep it simple

In most cases, you don't need an elaborate recordkeeping system to keep your affairs in order. File tax returns separately by year, and file investment records by broker. For expenses, even an accordion file tabbed by category works wonders.

If you have any questions or need assistance in setting up a recordkeeping system, give us a call. ♦

**To wish you** a happy holiday and a healthy and prosperous new year.

**To thank you** for your business in 2009 and to say we look forward to serving you in 2010.

**To remind you** that we welcome your referrals. We are a growing firm, and we would be pleased to have you mention our name to your friends and associates.

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# what the IRS is up to

## CARS income to dealers, not to buyers

In an "Automotive Alert," the IRS tells car dealers that vouchers provided to buyers to use in purchasing new cars and trucks under the CARS program (also known as the "cash for clunkers" program) are treated as gross income to the selling dealers. The voucher is not income to the buyer of the vehicle. The dealership's gross income includes the selling price of the vehicle and any payment for the scrap value of the trade-in vehicle. The gross income is offset by the dealer's cost of the vehicle and costs of administering the CARS program, including the cost of disposing of the trade-in vehicle.

## IRS payroll audits delayed

The IRS will delay until next February random payroll tax audits that were scheduled to begin in November 2009. These audits will focus primarily on worker classification, fringe benefits, officer's compensation, and reimbursed expenses.

The payroll audits are part of the IRS's commitment to closing what is estimated to be a $20 billion employment tax gap (the difference between taxes owed and taxes actually paid).

## Tax refunds can buy savings bonds

Taxpayers will be allowed to buy savings bonds with their tax refunds beginning in early 2010. The purchase of Series I bonds can be done by checking a box on the taxpayer's tax return.

In 2010 bonds can be purchased in the taxpayer's name; beginning in 2011, names of co-owners (e.g., children and grandchildren) can be added. ♦

## Important DATES

### WINTER 2009-10

- **January 15, 2010**
  Due date for the fourth installment of 2009 individual estimated tax.
- **February 1**
  Employers must furnish W-2 statements to employees. 1099 information statements must be furnished by banks, brokers, and other payers.
- **February 1**
  Employers must file 2009 federal unemployment tax returns and pay any tax due.
- **March 1**
  Payers must file information returns (such as 1099s) with the IRS.*
- **March 1**
  Employers must send W-2 copies to the Social Security Administration.*
- **March 1**
  Farmers and fishermen who did not make 2009 estimated tax payments must file 2009 tax returns and pay taxes in full. ♦

*March 31 if filing electronically.

*This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*