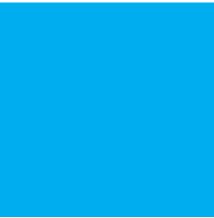
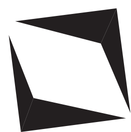
2010



YEAR-END TAX PLANNING



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2010 YEAR-END TAX PLANNING

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In 2010, year-end tax planning is more important than ever. Many advantageous tax provisions are set to expire at the end of the year. Taking a fresh look at your tax picture now may show you novel ways to take advantage of traditional planning strategies and suggest new tax-saving opportunities.

In *Year-End Tax Planning 2010*, you will find helpful explanations of the current tax rules and what to expect in 2011, along with action tips for lowering your 2010 federal income taxes. Read the whole booklet — or turn to the sections that interest you most. But know that most of the strategies discussed will be effective only if they are implemented before the end of the year.

We encourage you to secure professional tax advice before acting on any of the ideas presented in this booklet. The federal tax law is complex. You'll want the assistance of an expert to determine whether a particular strategy is right for you.

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PERSONAL INCOME & TAXES

A good way to begin your planning is to review the individual tax rates and your 2010 income.

CHANGING TAX BRACKETS

Knowing your marginal tax bracket lets you project the tax effect of various planning strategies. The IRS adjusts the individual tax brackets each year for inflation. You can see the 2010 brackets in the table on page 3.

For 2010 year-end planning, it's also important to be aware of changes in store for 2011. Unless Congress passes new legislation, the top four tax brackets will revert from their current 25%, 28%, 33%, and 35% levels (see table) to their pre-2001 levels of 28%, 31%, 36%, and 39.6%, and the 10% bracket will go away. The lowest bracket will be 15%.

INCOME TIMING

A traditional tax planning technique is to delay receiving taxable income until after the end of the year if it's economically feasible. By delaying income, you defer your taxes on that income. It also can keep you from losing tax breaks that are reduced or eliminated at higher income levels and prevent you from being pushed into a higher tax bracket.

But in 2010, you may want to consider *accelerating* income into 2010 in anticipation of the 2011 rate increases. Accelerating income into 2010 may make sense in other circumstances as well. Think about your 2011 income situation. For example, will your spouse be returning to work after several years out of the work force? If so, your combined income — and your highest marginal tax bracket — could increase next year. Or perhaps you have a child you'll no longer be able to claim as a dependent in 2011. The loss of that child's personal exemption could push you into a higher tax bracket next year.

WILL YOU BE SUBJECT TO AMT?

Regular income tax isn't the only tax you may have to pay on your 2010 income. You also could be liable for the alternative minimum tax (AMT) — even if you haven't paid it in recent years. Absent legislative relief, the AMT exemption amounts for 2010 (see table) will be significantly lower than they were in 2009.

Paid in addition to regular income tax, AMT is designed to ensure that taxpayers pay a minimum amount of tax when they use certain deductions, credits, and exclusions to reduce their regular tax liability. Items that can trigger AMT include:

- A higher-than-average number of dependency exemptions
- A large deduction for state income taxes
- The exercise of incentive stock options
- Tax-exempt interest from certain "private activity" municipal bonds
- A large deduction for unreimbursed employee business expenses or miscellaneous expenses
- Interest on a mortgage not used to buy, build, or improve your home
- A large capital gain

2010 AMT RATES

TAXABLE AMT INCOME	RATE
$1 to $175,000*	26%
Over $175,000*	28%

Unless Congress takes action to raise them, the 2010 AMT exemption amounts will be:

- $33,750 for unmarried filers
- $45,000 for married couples filing jointly
- $22,500 for a married person filing separately

The exemptions are phased out for higher income taxpayers.

** $87,500 for married taxpayers filing separately*

YOUR 2010 TAX PAYMENTS

Most taxpayers are required to make payments toward their federal income-tax liability during the year. Employees generally pay their taxes through payroll withholding. If you

ESTIMATE YOUR 2010 TAXABLE INCOME

	2009	2010
Wages, salaries, tips, etc.	$	$
Interest and dividends		
Business income (loss)		
Farm income (loss)		
Capital gain (loss)		
Rents, royalties, partnerships, S corporations, trusts, etc.		
Unemployment compensation		
Alimony received		
Taxable Social Security benefits		
Taxable distributions from IRAs, pensions, and annuities		
Taxable refunds of state and local income taxes		
Other income		
TOTAL ESTIMATED INCOME	**$**	**$**
ADJUSTMENTS (ABOVE-THE-LINE DEDUCTIONS)*		
Alimony paid		
Traditional IRA contributions		
Student loan interest		
Health savings account contributions		
One half of self-employment tax		
Self-employment health insurance premiums		
Self-employed SEP, SIMPLE, and qualified retirement plan contributions		
Early withdrawal (savings) penalties		
TOTAL ADJUSTMENTS	**$**	**$**
ADJUSTED GROSS INCOME (AGI) (TOTAL ESTIMATED INCOME MINUS TOTAL ADJUSTMENTS)	**$**	**$**
Minus exemptions	$	$
Minus standard deduction or itemized deductions	$	$
TAXABLE INCOME	**$**	**$**

** This list is not all-inclusive, and various requirements and limitations apply.*

2010 INCOME-TAX RATES

TAXABLE INCOME BRACKETS

RATE	SINGLE	HEAD OF HOUSEHOLD	MARRIED FILING JOINTLY (AND SURVIVING SPOUSES)	MARRIED FILING SEPARATELY
10%	$0 – 8,375	$0 – 11,950	$0 – 16,750	$0 – 8,375
15%	$8,376 – 34,000	$11,951 – 45,550	$16,751 – 68,000	$8,376 – 34,000
25%	$34,001 – 82,400	$45,551 – 117,650	$68,001 – 137,300	$34,001 – 68,650
28%	$82,401 – 171,850	$117,651 – 190,550	$137,301 – 209,250	$68,651 – 104,625
33%	$171,851 – 373,650	$190,551 – 373,650	$209,251 – 373,650	$104,626 – 186,825
35%	Over $373,650	Over $373,650	Over $373,650	Over $186,825

ACTION TIPS

TIME INCOME

- If you suspect your marginal tax rate will be higher in 2011 than in 2010, see if you can arrange to receive a bonus or commission payment in 2010, rather than in 2011.
- Or make a withdrawal from your traditional IRA earlier than planned, if you're over age 59½ and want to accelerate income.
- To defer income, you might want to ask your employer to postpone paying your year-end bonus or a late-year commission until after the first of the year.
- Another deferral strategy: Invest in Treasury bills that don't mature until next year or in CDs that won't let you take out interest without penalty until 2011. The interest earned would be reported on your 2011 return.
- Rolling over a qualifying distribution from a former employer's retirement plan to an individual retirement account (IRA) or a new employer's plan can avoid current income taxes on the distribution and allow you to continue building your retirement savings.

MINIMIZE AMT

- Consider pushing expenses that are deductible for regular tax purposes but not for AMT purposes — such as state and local taxes and miscellaneous itemized deductions — into a non-AMT year.
- Put off exercising incentive stock options or recognizing a large taxable capital gain on the sale of investment property if these actions will subject you to AMT.
- Alternatively, you might accelerate income into an AMT year if your regular income-tax rate is higher than the 28% AMT rate.
- If you are considering municipal bond investments, check their AMT status. Interest paid on private activity bonds issued in 2009 and 2010 is not considered an AMT tax-preference item. Details on page 6.

have non-wage income — rental income, self-employment earnings, alimony, investment income, etc. — you generally must make quarterly estimated tax payments (or have your employer withhold more to cover the tax on your non-wage income).

SOCIAL SECURITY BENEFITS

If you are receiving Social Security retirement benefits, those benefits won't be taxable unless your "provisional income" — basically your adjusted gross income (AGI) with certain modifications plus one half of the Social Security benefits — exceeds certain levels. Then, up to 85% of your benefits may be subject to income taxes.

WILL YOUR SOCIAL SECURITY BENEFITS BE TAXABLE?

ON A JOINT RETURN*

If your provisional income is:	Up to this percentage of your benefits will be taxed:
Less than $32,000	0%
Between $32,000 and $44,000	50%
Over $44,000	85%

ON A SINGLE OR HEAD-OF-HOUSEHOLD RETURN

If your provisional income is:	Up to this percentage of your benefits will be taxed:
Less than $25,000	0%
Between $25,000 and $34,000	50%
Over $34,000	85%

** For married persons filing separately who do not live apart from their spouse for the entire year, the provisional income threshold is zero.*

YOUR INVESTMENTS

All income is not created equal for tax purposes. Capital gains and dividends, for instance, are taxed differently — and more favorably — in 2010 than ordinary income. Knowing how investment income is taxed can help you secure more favorable tax treatment.

SELLING INVESTMENTS

Planning for investment gains can reduce your tax bill significantly. Tax rates on ordinary income and short-term capital gains are currently as high as 35%. Net long-term capital gains — gains on investments held more than one year before sale — generally are taxed at a maximum rate of 15% in 2010. The rate that applies to long-term capital gains that would otherwise be taxed at a 10% or 15% ordinary rate is 0%, but not for long. As you can see in the table, the tax rates on capital gains are scheduled to increase in 2011.

When you sell an investment, you figure your capital gain or loss by comparing your "basis" in the investment (usually, your cost) to the amount you receive from the sale. This calculation is fairly simple if you sell or redeem all of an investment at one time. It's more complicated when you have invested in shares of a particular stock or mutual fund at different times and prices and you decide to sell just a portion of your investment. We can help you determine which of the several methods available for figuring basis and gain (or loss) is best for you.

SMALL BUSINESS STOCK

Individual taxpayers may exclude from income a portion of capital gain realized when they sell "qualified small business stock" (QSBS) held more than five years. (Other requirements apply.) Generally, you may exclude 50% of up to $10 million (or 10 times your basis, if greater) of your gain. However, this exclusion has been temporarily increased to 75% for QSBS purchased after February 17, 2009, and before 2011. The remaining gain is taxable at a maximum 28% rate.

CHANGING CAPITAL GAINS TAX RATES

TAX RATE ORDINARY INCOME	TAX RATE CAPITAL GAINS		
2010	SHORT-TERM ≤ 1 YEAR	LONG-TERM > 1 YEAR	
10%	10%	0%	
15%	15%	0%	
25%	25%	15%	
28%	28%	15%	
33%	33%	15%	
35%	35%	15%	
2011	SHORT-TERM ≤ 1 YEAR	LONG-TERM > 1 & ≤ 5 YEARS	LONG-TERM > 5 YEARS
15%	15%	10%	8%
28%	28%	20%	18%*
31%	31%	20%	18%*
36%	36%	20%	18%*
39.6%	39.6%	20%	18%*

TAX RATE ON LONG-TERM GAINS	2010	2011
Collectibles	28%	28%
Qualified small business stock held more than five years (only a portion of the gain is taxed)	28%	28%
Real estate (amount up to prior allowable depreciation; rest of gain is taxed as other investments)	25%	25%

** For property purchased after 2000*

ACTION TIPS

PLAN FOR GAINS

- When you are going to sell appreciated securities, you might try to wait to sell them until you have met the more-than-one-year holding period required for long-term capital gain treatment. Remember, though, that taxes are only one consideration in the decision to sell or hold an investment.
- If you are planning to sell any long-term investments at a gain, you may want to do so before year-end 2010 to take advantage of the lower capital gains rates.
- If you sell appreciated property in 2010 and the transaction is structured as an installment sale, electing out of the installment method would give you the benefit of the lower 2010 capital gains rate on more of your gain. The tradeoff: You'll lose the benefit of tax deferral that comes with installment sale treatment.

LIMIT CAPITAL GAIN EXPOSURE

- If you like a certain stock and believe it still has potential for additional appreciation, you could donate your shares to charity, eliminating the capital gain exposure, and then buy the stock again at market price. Along with a deduction for your contribution, this strategy would give you a cost basis in the stock equal to the current value.

MANAGE LOSSES

- To accelerate losses without significantly changing your investment position, consider selling securities, taking the loss, and replacing them with securities of another company in the same industry having similar prospects. This strategy avoids the wash-sale rules.
- Similarly, you can "double up" on the securities, wait 31 days, and then sell your original securities at a loss. But pay attention to any dividend payments during the wash-sale period. If they are reinvested in additional shares, you may lose your ability to deduct part of your original loss.

LOSSES CAN OFFSET GAINS

Capital losses are fully deductible against capital gains. You can deduct any excess losses against ordinary income of up to $3,000 a year ($1,500 if married filing separately). Additional losses may be carried forward to later tax years. A traditional approach to reducing taxes is to time capital losses to offset capital gains.

As you plan, you'll want to pay attention to the tax law's "wash sale" rules. Under these rules, if you sell securities at a loss and purchase substantially identical securities within *30 days before or after* the sale, your loss will be disallowed.

QUALIFYING DIVIDENDS — A LIMITED OPPORTUNITY

Like long-term capital gains, qualifying dividends are generally taxed at a maximum rate of 15% in 2010 (0% for dividends otherwise taxable in the lowest two ordinary tax brackets). Unless Congress takes action, however, in 2011, dividends will be taxed at the higher ordinary income rates.

To ensure favorable dividend treatment in 2010, you'll need to have held the underlying stock for a minimum period. In general, the minimum holding period is 61 days during the 121-day period beginning 60 days before the stock's "ex-dividend" date (the date on which the stock begins trading without rights to the most recently declared dividend).

PRIVATE ACTIVITY BONDS

Generally, tax-exempt interest on so-called "private activity" municipal bonds (for example, those used to fund private sector projects) is included as a tax-preference item for AMT purposes. Thus, interest that is tax exempt for regular tax purposes is included in income for AMT purposes. For qualifying private activity bonds issued (or, in certain cases, reissued) in 2009 and 2010, however, taxpayers receive a break. As part of the economic stimulus effort, interest paid on these bonds is not considered an AMT tax-preference item.

NEW TAX ON INVESTMENT INCOME

Looking ahead, the health care reform law enacted earlier this year (the Patient Protection and Affordable Care Act, as amended) imposes a Medicare tax on the investment income of higher income individuals, estates, and trusts, starting in 2013. For individuals, the tax will be equal to 3.8% of the lesser of (1) net investment income or (2) the excess of modified AGI over $200,000 (single; head of household), $250,000 (married filing jointly), or $125,000 (married filing separately).

PERSONAL DEDUCTIONS & CREDITS

ABOVE-THE-LINE DEDUCTIONS

Timing deductible expenses for the greatest tax benefit is a classic year-end planning strategy. First on the list: expenses that are deductible "above-the-line" as adjustments to income. See page 3 for some examples. Above-the-line deductions are valuable because they reduce your AGI *and* help you preserve tax breaks you might otherwise lose because your AGI is too high.

PERSONAL EXEMPTIONS

You generally can claim an exemption for yourself and another for your spouse, if you're married. You are also allowed an exemption for each dependent (a qualifying child or qualifying relative who meets certain tests). In 2010, each exemption you claim reduces your taxable income by $3,650.

In 2010, the phaseout that reduced exemption amounts for higher income taxpayers in previous years no longer applies. You can claim the full exemption amount in 2010, no matter what your income. The phaseout is scheduled to return in 2011.

TAX BREAKS SUBJECT TO AGI LIMITS

- Individual retirement accounts:
  - Deduction for traditional IRA contribution (if you or your spouse participates in an employer's plan)
  - Ability to contribute to a Roth IRA (other than through a conversion)
- Student loan interest deduction
- Medical expense deduction
- Miscellaneous itemized expense deduction
- Child credit
- Child care credit
- Adoption credit
- American Opportunity credit
- Lifetime Learning credit
- Homebuyer credit
- Mortgage insurance premium deduction

ITEMIZED DEDUCTIONS

Over the past several years, individual taxpayers have had their itemized deductions reduced if their income exceeded a certain threshold. Not in 2010. The reduction is eliminated for 2010 but is scheduled to return in 2011.

DEDUCTIBLE TAXES

If you itemize, you can claim deductions for state and local income taxes, real property taxes, personal property taxes, and foreign income taxes (or claim a foreign tax credit).

INVESTMENT INTEREST

Be sure to include any deductible investment interest you pay in 2010 in your itemized deductions. You can deduct interest paid on loans used to buy or carry taxable investments — a margin loan, for example. The amount of interest you can deduct is limited to your net investment income for the year. You cannot include net capital gain or qualified dividends in your investment income for this purpose unless you forgo the favorable tax rates on that income and subject it to tax at your higher ordinary rate. Excess investment interest expense that you can't deduct currently can be carried forward for deduction in subsequent years, subject to that year's limitation.

CHARITABLE DONATIONS

You can help your favorite charities and your tax situation by making year-end contributions. You may count a check mailed on December 31, 2010, as a 2010 contribution even though the organization does not receive it and it does not clear the bank until 2011. For all your cash contributions, you must have a bank record or a receipt from the charitable organization showing the name of the charity, the contribution date, and the contribution amount.

"FLOOR EXPENSES"

Certain itemized deductions are subject to "floor" amounts set by law. Only amounts over and above the floor are deductible. Looking at your deductible expenses now may save you from an unpleasant surprise at tax time. In 2010, you may deduct unreimbursed medical expenses only to the extent that together they exceed 7.5% of your AGI. The floor is 2% of AGI for miscellaneous itemized deductions — including unreimbursed employee business expenses, various expenses related to your investments, and certain other items.

FOR HOMEOWNERS

One of the advantages of homeownership is the ability to deduct qualifying mortgage interest paid. Interest on up to $100,000 of qualifying home equity debt is also deductible, regardless of how you use the loan proceeds. You also may be able to deduct:

- Mortgage "points" (prepaid interest) in full in the year you purchase the home
- Points paid on a mortgage refinancing for home improvements in full in the year you enter the loan, if you pay the points from separate funds
- Points you pay to refinance an existing mortgage over the life of a loan
- Remaining unamortized points in the year you pay off or refinance your loan

If you obtained a qualified mortgage after 2006, your mortgage insurance premiums may be deductible (as if they were qualified residence interest). This deduction is subject to phaseout if your AGI is over $100,000 ($50,000 if married filing separately). The deduction for mortgage insurance premiums will no longer be available after 2010.

Did you buy a principal residence this year? If you purchased your home before May 1, 2010 (or entered into a written binding contract for the purchase before May 1 and closed on the purchase before July 1), you may be eligible for a homebuyer credit. The tax credit is available to both eligible "first-time" homebuyers and "long-time residents" who purchased homes. See "Homebuyer Credit at a Glance."

EDUCATION EXPENSES

The tax law also has breaks to help taxpayers with college expenses. In 2010, an American Opportunity tax credit is available for payment of qualified tuition and related expenses for any of a student's first four years of college. For 2010, the maximum credit is $2,500 (100% of up to $2,000 of expenses plus 25% of the next $2,000 of expenses) for each eligible student in your family. Students must be enrolled at least half-time. If all requirements are met, taxpayers may be able to benefit even if the

HOMEBUYER CREDIT AT A GLANCE

	FIRST-TIME HOMEBUYER	LONG-TIME RESIDENT
Definition	No ownership of principal residence in U.S. during three-year period before purchase	Owned and used same principal residence for at least five consecutive years during eight-year period ending on purchase date
Maximum credit	$8,000* $4,000 married filing separately	$6,500* $3,250 married filing separately
Credit phaseout	$125,000 to $145,000 AGI (single) $225,000 to $245,000 AGI (joint)	$125,000 to $145,000 AGI (single) $225,000 to $245,000 AGI (joint)
Maximum purchase price	$800,000	$800,000

** Or 10% of purchase price if less*

amount of the credit is more than their tax liability.

A Lifetime Learning tax credit is available for qualified tuition and related expenses paid for courses to acquire or improve job skills, as well as for undergraduate- and graduate-level courses at an eligible educational institution. The credit is 20% of up to $10,000 of expenses, to a maximum of $2,000 per return. You can't claim both the American Opportunity and the Lifetime Learning credits for the same student's expenses.

The American Opportunity tax credit is phased out for joint filers with modified AGI between $160,000 and $180,000 and for single filers with AGI between $80,000 and $90,000. The Lifetime Learning tax credit is phased out for joint filers with modified AGI between $100,000 and $120,000 and for single filers with AGI between $50,000 and $60,000.

Qualified student loan interest of up to $2,500 is deductible in 2010. The deduction phases out for joint filers with modified AGI between $120,000 and $150,000 and for single taxpayers with AGI between $60,000 and $75,000.

ENERGY-RELATED BREAKS

You may be able to claim a 30% tax credit for the costs of making certain energy-efficient improvements to your principal residence in 2010 (such as energy-saving exterior doors, windows, insulation, and roofs) and for the installation of qualified energy property (such as a furnace or water heater). There is an aggregate cap on the credit of $1,500 for property placed in service in 2009 and 2010. This credit expires after 2010.

Installing qualified solar energy, small wind energy, or geothermal heat pump property in your principal residence or second home or installing qualified fuel cell property in your principal residence can also earn you a 30% energy credit. Various requirements apply.

And energy-related credits aren't limited to your home. Credits are available for purchasing certain IRS certified energy-efficient vehicles. The credit amount varies with the type of vehicle, and a credit may not be available once sales of a particular model exceed a certain number. Credits for purchasing several types of alternative vehicles are set to expire after 2010.

ACTION TIPS

MAXIMIZE EXEMPTIONS

- If you support an elderly parent or other qualifying relative, you can claim a dependency exemption for that family member if you meet certain conditions. Basically, you have to provide more than 50% of that person's support, and his or her annual gross income (not including tax-free Social Security benefits) can't exceed the personal exemption amount ($3,650 for 2010). Monitor the support you are providing near the end of the year if you believe you could qualify for an exemption.

BUNCH DEDUCTIONS

- One way to deduct more of your medical and miscellaneous expenses is to "bunch" two years of expenses into one year so you exceed the applicable deduction floor. To boost your medical deduction for 2010, you could schedule and pay for elective surgery, dental work, and eye appointments in late 2010.
- And consider whether deductions of any kind may be more valuable in 2011 in light of the expected higher tax rates.

TAKE ADVANTAGE OF CREDITS

- Your student child may be able to claim the American Opportunity tax credit or the Lifetime Learning credit for tuition expenses *you* paid on his or her behalf if no one claims your child as a dependent. This could be a family tax saver if your child can take advantage of the credit and your AGI is too high to claim the credit yourself.
- The dependent care credit isn't limited to children. If you support an elderly parent who lives with you, for instance, you may be able to claim a credit for household and dependent care expenses that enable you to work.

TAX-ADVANTAGED PLANS

RETIREMENT PLANNING

Contributing to an individual retirement account (IRA), an employer-sponsored retirement plan, or a retirement plan for the self-employed can reduce your taxable income — while you are putting aside money toward your retirement savings goal.

IRAs. Deductible contributions you make to a traditional IRA reduce your AGI. If you or your spouse participates in a retirement plan at work, your deduction for contributions to a traditional IRA may be subject to an income-based limitation.

With a Roth IRA, contributions aren't tax deductible, but account earnings will be distributed *tax free* when certain requirements are met. As with a traditional IRA, you (or your spouse) must generally have earnings from work to contribute to a Roth IRA. In 2010, eligibility to contribute to a Roth IRA is phased out as modified AGI rises from $105,000 to $120,000 for unmarried filers, $167,000 to $177,000 for joint filers, and $0 to $10,000 for married-separate filers.

Employer-sponsored Plans. With an employer-sponsored retirement savings plan — such as a 401(k), 403(b), or SIMPLE plan — your pretax contributions to the plan and any earnings on those contributions won't be subject to federal income taxes until you begin receiving funds from the plan.

Some employers also allow employees to make after-tax Roth contributions to their 401(k) or 403(b) retirement savings plans. Roth contributions are subject to current income taxes, but once in the plan, the contributions grow tax deferred. Withdrawals of both Roth contributions *and* related earnings are not taxed if certain requirements are met. Talk with us to find out whether Roth contributions would benefit you.

HOW MUCH CAN YOU CONTRIBUTE FOR 2010?

To boost your retirement savings, contribute as much as possible each year. The maximum amounts are shown below. Note, however, that some employer plans might not permit participants who have reached age 50 to contribute the higher amounts indicated. And additional contribution limitations could apply.

TYPE OF PLAN	UNDER AGE 50	AGE 50 OR OLDER
Traditional/Roth IRA	$5,000	$6,000
401(k), 403(b), 457, SEP*	$16,500	$22,000
SIMPLE IRA	$11,500	$14,000

** Only SEP plans established before 1997 may allow employees to make pretax contributions.*

FOR THE SELF-EMPLOYED

If you're self-employed full-time or in a sideline business, you also have retirement savings options:

- **SIMPLE IRAs**
- **Simplified Employee Pensions (SEPs)**
- **Solo 401(k)s**
- **Keogh Plans**

ROTH CONVERSIONS

Starting in 2010, anyone can convert all or part of a traditional IRA into a Roth IRA regardless of income or filing status. You also may convert a SIMPLE IRA (after two years of participation) or a SEP IRA. Before 2010, Roth IRA conversions were allowed only if your modified AGI was $100,000 or less and you didn't file as a married-separate taxpayer.

A Roth IRA provides you with income-tax-free retirement income. Also, you don't have to take required minimum distributions from a Roth IRA as you do with a traditional IRA. The tradeoff for these advantages: When you convert a traditional IRA to a Roth IRA, any deductible contributions you've made and any accumulated earnings in the traditional

IRA become taxable. However, even if you're younger than age 59½, you won't be liable for the 10% early withdrawal penalty on the conversion.

Also starting in 2010, you can roll over eligible distributions from employer-sponsored plans, such as 401(k), 403(b) annuity, and 457 governmental plans, into a Roth IRA, regardless of your income. Previously, the same income and filing status restrictions that applied to IRA conversions applied to these rollovers. When you roll over from an employer plan to a Roth IRA, you must report the resulting income for tax purposes.

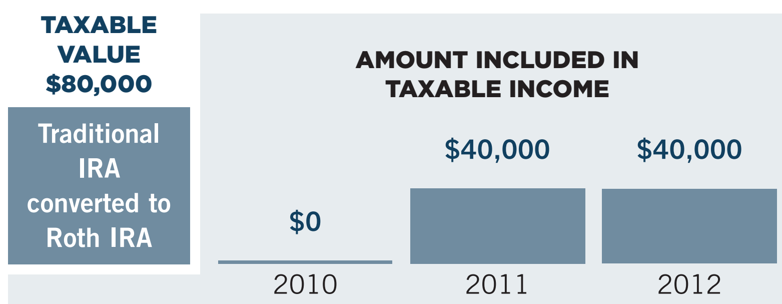
Determining the tax consequences of a full or partial Roth conversion can be complicated. We can help you analyze whether a conversion would be beneficial for you and your family.

FSA TAX BENEFITS

If your employer offers a flexible spending arrangement (FSA), take advantage of the tax benefits it offers. With an FSA, you elect to pay health or dependent care expenses on a pretax basis. The plan reimburses you from the account for amounts you spend on expenses allowed by the plan. (Some plans allow employees to use a plan-provided debit or credit card to pay expenses directly.)

2010 CONVERSIONS: A SPECIAL TAX DEAL

A special rule that applies for 2010 *only* allows you to defer the income from a Roth conversion and spread it ratably over two years, *2011 and 2012*.



You don't have to use the special rule. You can choose to have all of the income generated by the conversion included in your 2010 income and pay the resulting taxes.

ACTION TIPS

PLAN FOR DISTRIBUTIONS

- If you are retiring or leaving your employer for another job and will be receiving a lump-sum distribution from your employer's retirement savings plan, consider rolling over the distribution to an IRA or your new employer's plan (if permitted) within 60 days. You'll postpone current income tax on the distribution and continue to defer tax on account earnings.
- If a portion of the lump-sum distribution includes appreciated company stock, consider taking the stock instead of rolling it over if the distribution qualifies for "net unrealized appreciation" (NUA) tax treatment. Basically, you'll have to pay current income tax but only on the stock's basis (generally, its value when it was added to your account). Any increase in the stock's value after that time won't be taxed until you sell the stock and realize a capital gain. Thus, you stand to benefit from deferral and the favorable long-term capital gains tax rate. (These rules are complex, so please discuss them with us in advance.)
- If you are considering a late year IRA conversion, be aware that you must take any required minimum distributions (RMDs) for 2010 from your traditional IRA before you convert it to a Roth IRA. Generally, individuals age 70½ and older must take RMDs.

FSA CHANGE

- After 2010, FSA money can no longer be used to buy over-the-counter medicines or drugs (such as antacids, allergy medicines, pain relievers, and cold medicines) unless a doctor prescribes them. If you've been using your FSA for these items, you may want to stock up before year-end.

BUSINESS INCOME & TAXES

The tax accounting method your business uses determines when income must be recognized for tax purposes and when expenses are deductible. Cash-method taxpayers report income when it is actually or constructively received and deduct expenses when payments are actually disbursed.

Accrual-method taxpayers report these items for tax purposes in the year that their right to the income becomes final and all events have occurred creating the liability to pay the deductible expenses. In addition, you must be able to determine the amounts with reasonable accuracy.

BUSINESS STRUCTURE

The structure of your business — C corporation, S corporation, partnership, limited liability company (LLC), or sole proprietorship — determines how your business income is taxed. A regular C corporation pays tax on its income at corporate tax rates (see table). Generally, the income, losses, deductions, and credits of an S corporation, partnership, or LLC are passed through to the owners to be reported on their tax returns. Sole proprietors also report business income and deductions on their personal tax returns.

DISTRIBUTING EARNINGS

If your business is organized as a C corporation, you may want to review alternatives for distributing corporate earnings. Amounts paid as dividends are not deductible by the corporation and represent taxable income to you and the other shareholders who receive them. But, as discussed in the section on investments, you'll pay tax on qualified dividends at a maximum rate of 15% through 2010.

Compensation is deductible by the company (as long as it is reasonable in amount) and taxable to you as ordinary income. Thus, the income is taxed only once at your ordinary rate.

Your corporation can retain amounts not distributed for later use. However, if a company accumulates excessive amounts of retained earnings to avoid paying taxable dividends to shareholders, the IRS can assess an accumulated earnings tax penalty.

CORPORATE TAX RATES

If your company is a C corporation other than a personal service corporation,* you can estimate your corporation's regular 2010 federal income taxes using this table.

IF TAXABLE INCOME IS OVER	BUT NOT OVER	YOUR TAX IS	OF THE AMOUNT OVER
$0	$50,000	15%	$0
$50,000	$75,000	$7,500 + 25%	$50,000
$75,000	$100,000	$13,750 + 34%	$75,000
$100,000	$335,000	$22,250 + 39%	$100,000
$335,000	$10,000,000	$113,900 + 34%	$335,000
$10,000,000	$15,000,000	$3,400,000 + 35%	$10,000,000
$15,000,000	$18,333,333	$5,150,000 + 38%	$15,000,000
$18,333,333		A flat 35%	

** Personal service corporations pay a flat 35% tax.*

HOW BUSINESS INCOME IS TAXED

FORM OF BUSINESS	TAXED TO BUSINESS ENTITY?	TAXED TO OWNER(S)?
C corporation	Yes	If distributed[1]
S corporation	No[2]	Yes
Partnership	No	Yes
Limited liability company[3]	No	Yes
Sole proprietorship	No	Yes

[1] *Unlike dividends, salaries paid to owners employed by the corporation are tax deductible.*

[2] *Some exceptions apply.*

[3] *If classified as a partnership or a noncorporate single member LLC.*

Generally, a corporation can accumulate up to $250,000 of earnings ($150,000 in the case of certain service corporations) without penalty.

ALTERNATIVE MINIMUM TAX

The AMT can be an issue for larger corporations. As is the case with the individual AMT, computing the corporate AMT is complex. When it applies, the corporate AMT rate is 20%, and the exemption amount is $40,000 (subject to an income-based phaseout). However, small corporations that meet a gross receipts test are *exempt* from the AMT. To qualify for the exemption, a corporation's average annual gross receipts for all three-tax-year periods beginning after 1993 and ending before the current tax year generally can't be more than $7.5 million. (A lower $5 million threshold applies for the first three-tax-year period taken into account in the test.)

ACTION TIPS

REVIEW YOUR BUSINESS FORM

- As a preliminary step in your year-end planning, look at your current form of doing business. You may discover that another structure would be more beneficial. Remember, though, that taxes are just one consideration.

TIME INCOME

- If you expect your C corporation to be in a substantially higher tax bracket in 2011, you may want to accelerate corporate income into 2010. If not, deferring income is probably the way to go.
- Delaying billing notices so that payment won't be received until early next year would allow your business to defer income if it is a cash-method taxpayer.
- As an accrual-method taxpayer, you might defer income by delaying shipping products or providing services until the beginning of your 2011 tax year.
- Making year-end shipments FOB destination, rather than FOB shipping point, can delay the transfer of title until next year. Income won't be realized until title passes.
- Certain advance payments received for the sale of goods or services may be deferred by an accrual-method business if requirements are met.

PLAN DISTRIBUTIONS

- When making decisions about distributing earnings from your C corporation, consider all of the tax factors.
- If your corporation has a reasonable business purpose for accumulating earnings greater than the $250,000/$150,000 that may trigger the accumulated earnings tax penalty — the anticipated purchase of new equipment or the purchase or construction of new facilities, for instance — document why the additional money is needed in the corporate minutes.

BUSINESS DEDUCTIONS & CREDITS

Deductions and tax credits help minimize the taxes on your business income. Staying informed about tax law developments is important, since a number of deduction and credit opportunities are available only for a limited time.

TIMING

As year-end approaches, you may be able to accelerate certain deductible and credit-eligible expenses into the current tax year. However, if you anticipate a substantial increase in business income next year — with a corresponding higher tax rate — postponing expenses until 2011 may be more tax effective.

ASSET PURCHASES

Being able to recover some of the costs of newly acquired business assets over time through depreciation is an important tax benefit for businesses. *When* you purchase assets and *how* you choose to depreciate them can make a difference in your tax bill.

In general, businesses may claim a full half-year's depreciation deduction for equipment and various other assets (not real estate) purchased and placed in service late in the year. This means that last-minute asset purchases could result in significant tax savings. But be mindful of an exception: You can't use the half-year convention if more than 40% of the year's total additions are made during the last three months of the year. Instead, you must treat all the assets as though you acquired them in the middle of the appropriate quarter.

Your business may be able to elect under Section 179 of the tax code to currently deduct ("expense") the cost of qualifying assets instead of depreciating them. For 2010, the Section 179 expensing limit is generally $250,000. However, you cannot expense more than the amount of your taxable income from active trades or businesses, and the amount of the available expensing election

DEPRECIATION ASSET CLASSES

PROPERTY CLASS	ASSETS INCLUDED
3-year	Tractor units for over-the-road use
5-year	Automobiles, trucks, computers, copiers and other office machinery
7-year	Office furniture and fixtures
10-year	Vessels, barges, tugs
15-year	Certain land improvements
20-year	Farm buildings (other than certain single-purpose structures)
25-year	Water utility property
Residential rental property	Apartment buildings, single-family rental properties
Nonresidential real property	Office buildings, stores, warehouses

These asset classes are used when computing depreciation under the Modified Accelerated Cost Recovery System (MACRS). The lists of property included in each class are not all-inclusive.

is reduced dollar for dollar as annual asset purchases rise from $800,000 to $1,050,000. (Real property doesn't qualify for the expensing election.) Any part of an asset's cost that is expensed cannot also be depreciated.

DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

This deduction is available to companies involved in domestic manufacturing, construction, engineering or architectural services related to construction projects, and other eligible production activities. For 2010, the deduction is 9% (up from 6% in 2009) of the lesser of: (1) qualified production activities income or (2) taxable income before taking the deduction into account. (Sole proprietors use their adjusted gross income, with certain modifications, instead of their taxable income.) However, the deduction can't exceed 50% of W-2 wages allocable to domestic production gross receipts. If your company is eligible, the deduction could cut your taxes — and increase your after-tax profits — without any additional outlay of cash.

START-UP COSTS

If you launch a new business this year, you may incur expenses before the business actually begins operating. Examples include the costs of conducting market surveys, traveling to find customers or suppliers, advertising, and training employees. You can elect to expense up to $5,000 of these expenses in 2010 as long as the business is up and running by year-end. (The $5,000 limit is reduced dollar for dollar once total start-up costs exceed $50,000.) The remainder of the costs can be deducted ratably over a 180-month period.

FOR THE SELF-EMPLOYED

If you're self-employed, you may deduct half of your self-employment tax in computing your AGI. In 2010, the 12.4% OASDI (Social Security) part of the tax applies to self-employment earnings of up to $106,800. The 2.9% Medicare tax applies to all your self-employment income.

You might consider hiring your children to work in your business part-time. As long as you pay them a reasonable amount for the work they do, you can deduct their compensation — potentially moving highly taxed business income into your child's lower personal tax bracket. And, if your business is unincorporated, you don't have to pay FICA tax on the wages paid to your child if he or she is under age 18.

ACTION TIPS

ACCELERATE/INCREASE DEDUCTIONS

- You might have equipment or vehicle repairs done or purchase supplies before year-end if these expenses would be incurred in 2011 anyway.
- If you're an accrual-method taxpayer, you have a little more freedom to accelerate deductions. Look at deducting employee bonuses that you don't plan to pay until early next year (within the first 2½ months of 2011). But take care if a condition of receiving a bonus is that the recipient still be employed on the bonus payment date. In that case, you won't be able to claim the deduction until 2011. Also, you generally can't use this strategy for employees who own a greater-than-50% interest in the business.
- You also may be able to deduct vacation pay that is vested at year-end and will be paid within 2½ months after year-end.
- To deduct charitable contributions that you have planned for early 2011, make sure you note the charitable obligation in the corporate minutes before the end of 2010.

CONSIDER SECTION 179 EXPENSING

- Think about purchasing equipment (with a loan, if necessary) that you'll need next year if you'll be able to claim the Section 179 deduction for the equipment in 2010.
- If you plan to make the expensing election but find that your total asset purchases for 2010 are already close to the $250,000 limit, you may want to postpone buying additional items until 2011.
- If you will elect Section 179 treatment for only some of your company's 2010 asset acquisitions and depreciate the others, it may make sense to use the election for the assets with the longest lives.

LOSSES

With the tenuous economy, you may expect your business to experience a net operating loss (NOL) in 2010. If so, you'll want to be sure you use the loss to your tax benefit. Consult with us.

Other potential loss deductions include:

- Business bad debts — but make sure you can substantiate your failed collection efforts
- Casualty and theft losses, including natural disaster losses
- Capital losses
- Losses on the sale of business assets

HIRING INCENTIVES

Under the Hiring Incentives to Restore Employment (HIRE) Act, your business may be exempt from paying the 6.2% employer share of Social Security employment taxes on wages paid to previously unemployed individuals hired after February 3, 2010, and before January 1, 2011. The new employee cannot be a replacement for a former employee *unless* the former employee was terminated for cause or left voluntarily. The new employee must certify by signed affidavit that he or she hasn't been employed for more than 40 hours during the 60-day period ending on the date employment begins. And the employee can't be "related" to the employer. This tax relief is available for wages paid to qualifying individuals after March 18 through the end of 2010.

And keeping a newly hired employee on for at least 52 consecutive weeks could provide you with a tax credit in the year the retention requirement is first satisfied. To qualify, the wages you pay the new employee during the last 26 weeks of the period must equal at least 80% of the wages paid for the first 26 weeks. The credit for *each* qualifying retained worker is equal to the lesser of (1) $1,000 or (2) 6.2% of wages paid to the retained worker during the 52-week period.

HEALTH INSURANCE TAX CREDIT

The Patient Protection and Affordable Care Act provides an incentive for employers with no more than 25 full-time (or full-time equivalent) employees to provide health insurance. (Annual wages must average no more than $50,000 per employee.) The Act offers qualifying employers a sliding-scale income-tax credit to help them pay for health insurance coverage for employees. For 2010 through 2013, the credit may be as much as 35% of the employer's contribution toward the coverage. In general, the employer must contribute at least 50% of the total premium cost.

LOOKING AHEAD

Of course, the health insurance tax credit isn't the only provision in the health care reform law that may affect your business and your taxes in the years ahead. For example, starting in 2013, an additional .9% Medicare tax will be imposed on wages and self-employment income exceeding certain thresholds. And, beginning in 2014, employers with an average of 50 or more full-time (or full-time equivalent) employees will be required to provide them with adequate minimum essential health care coverage or pay potential penalties.

TALK WITH US

By starting your year-end planning now, you'll have more time to accomplish your tax-saving goals. As skilled professionals, we have the experience and knowledge to help you with all your planning needs — now and in the coming years. For more information about our services, contact us today.

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