

Do you want to save money on your taxes?
Tax Planning Ideas for Individuals
November 2009

There are many tax planning strategies, but most of the time it is all about recognizing the opportunities that exist under your particular situation. Do you have opportunities to:

- Affect the timing of income and deductions;
- Tax advantage of tax credits;
- Maximize the tax savings from your charitable giving;
- Reduce/manage your AMT tax;
- Maximize retirement contributions; or
- Take advantage of allowable deductions?

TIMING OF INCOME AND DEDUCTIONS

Defer income and/or prepay expenses. Consider postponing income until 2010 and accelerating deductions in 2009 to lower your 2009 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2009 that are phased out over varying levels of adjusted gross income ("AGI"). These include IRA and ROTH IRA contributions, conversions of regular IRAs to ROTH IRAs, child credits, education tax credits, the above-the-line deduction for higher education expenses, and deductions for student loan interest. Postponing income is also desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances.

Acceleration of income. As a counterargument to deferring income, another consideration would be to plan for more income because you will have significantly lower income this year. For example, if you started a new business venture with large initial year losses, there may be an opportunity to accelerate income and take advantage of the shelter by rolling a taxable IRA into a tax free ROTH.

Defer a bonus. It may be advantageous to try to arrange with your employer to defer a bonus that may be coming your way until 2010.

Review your use of employer pre-tax spending accounts. Increase the amount you set aside for next year in your employer's health flexible spending accounts ("FSA"), if you set aside too little for this year. Do not forget you can set aside amounts to get tax free reimbursements for over-the-counter drugs, such as aspirin and antacids. Are you utilizing your employer's dependent care plan? These pre-tax employer plans not only reduce your income tax liability, but also your social security tax liabilities, and effectively eliminate recognition of income.

Does your employer offer HSA accounts? If you become eligible to make health care savings account ("HSA") contributions in December of this year, you can make a full year's worth of deductible HSA contributions for 2009.

Sell at a loss to offset earlier gains. If you have realized gains earlier in the year from sales of stock held for more than one year (long-term capital gains) or from sales of stock held for one year or less (short-term capital gains), review your portfolio and identify some of the losers - those shares that now show a paper loss. An advantageous tax strategy is to sell enough of the

losers to generate losses to offset your earlier gains plus an additional \$3,000 loss. Selling to produce this amount of loss is a good idea from the tax viewpoint because a \$3,000 capital loss (but no more) can offset a like amount of ordinary income each year.

Worthless stock is treated as sold. In some cases, the stock you own may have become completely worthless during the year. If so, you can claim a loss equal to your basis in the stock, generally what you paid for it. The stock is treated as through it had been sold on the last day of the tax year. This date is important because it affects whether your capital loss is long-term or short-term.

Bunch expenses into the current year. You may be able to save taxes this year by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions. You need to beware of potential AMT consequences. Consider extending your subscriptions to professional journals, paying union or professional dues, enrolling in (and paying tuition for) job related courses, etc. Consider using a credit card to prepay expenses.

Prepay your taxes. If you expect to owe state and local income taxes when you file your return next year, ask your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2009. You need to beware of potential AMT consequences. You may also want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.

Are you deducting all your flow through entity losses? If you own an interest in a partnership or an S corporation, you may need to increase your basis in the entity so you can deduct a loss from it for this year. You can recognize further losses by deducting unreimbursed ordinary and necessary business expenses you paid on behalf of the entity on Schedule E if you were required to pay these expenses under the partnership agreement (except amounts deductible only as itemized deductions, which you must enter on Schedule A).

Accelerated depreciation deductions on property used in a trade or business. The maximum Section 179 expense deduction you can elect for qualified property you placed in service in tax years that begin in 2009 remains at \$250,000. This limit is reduced by the amount by which the cost of section 179 property placed in services in the tax year exceeds \$800,000.

1031 exchange considerations on real estate. Will you be selling appreciated investment real estate before year end? You may want to consider deferring the gain by structuring the transaction under the provisions allowed under Code Section 1031. You should consider an exchange when you expect to acquire a replacement "like kind" property subsequent to the sale of an existing investment property.

TAKE ADVANTAGE OF TAX CREDITS

Congress continues to offer tax credits to individuals. Often people make decisions because of press about such credits and end up not able to benefit from them come tax time. You have to read the fine print.

Energy Credits. If you are thinking of making energy saving improvements to your home, such as putting in extra insulation or installing energy savings windows, get them done before December 31st. Tax credits are available at 30% of the cost, up to \$1,500 for 2009 and 2010 (for

existing homes only). Other credit incentives are available such as costs for solar panels, water heaters, etc.

Hybrid cars. If you are thinking of buying a hybrid vehicle eligible for a tax credit, verify that it is actually eligible for the credit. If so, purchase it before year-end.

Education credits and claiming dependency deductions, it may pay for you not to claim a dependency deduction for a child in college. There are a variety of education credits available this year. Depending on your income level and family situation, credits can be maximized should your child have enough taxable income. This requires weighing the benefit of the dependency exemption in conjunctions with available credits. The tax-cutting value of the education credits that the child can claim may be greater than the value to you for the dependency exemption for the child. Note, that the child cannot claim a personal exemption for him or herself if you are eligible, but do not, claim a dependency exemption for the child.

Expanded and revised higher education tax credit. New law during 2009 created a \$2,500 higher education tax credit that is available for the first four years of college. The credit is based on 100% of the first \$2,000 of tuition and related expenses (including books) paid during the tax year and 25% of the next \$2,000 of tuition and related expenses paid during the tax year, subject to a phase-out for AGI in excess of \$80,000 (\$160,000 for married couples filing jointly). 40% of the credit is refundable. The new credit temporarily replaces the Hope credit.

Credit for first-time home buyers. Congress has provided taxpayers with a refundable tax credit equal to 10% of the purchase of a home (up to \$8,000) by first-time home buyers. This provision applies to homes purchased through the end of November 2009. The credit phases out for taxpayers with AGI in excess of \$75,000 (\$150,000 in the case of a joint return).

MAXIMIZE THE TAX SAVINGS FROM CHARITABLE GIVING

Non-cash contributions. Remember to consider donating your used clothing, furniture, etc. before year end and keep your receipts.

Charitable donations of appreciated stock. This tax planning tool is derived from the general rule that the deduction for a donation of property to charity is equal to the fair market value of the donated property. Where the donated property is "gain" property, the donor does not have to recognize the gain on the donated property. These rules allow for the "doubling up" of tax benefits: a charitable deduction, plus avoiding tax on the appreciation in value of the donated property.

Charitable contribution of retirement benefits. Certain distributions from an IRA donated to a charitable organization may be made tax-free. Under this rule, taxpayers who have reached age 70 1/2 may exclude from gross income up to \$100,000 (for 2009) in distributions from a traditional individual retirement account (IRA) or Roth IRA that would otherwise be included in their income. The "qualified charitable distribution" must be made to a tax-exempt organization and must be made directly by the IRA trustee to the charitable organization.

Donating a used car to charity? Who has not heard a commercial on the radio advising you to donate your car to charity? For cars worth over \$500, the deduction will be the amount for which the charity actually sells the car, if it sells the car without materially improving it. This

limit applies to any motor vehicle designed for road use, including vans and trucks, as well as to boats and airplanes. If the charity plans to use the car in its charitable activities, you may yield a bigger deduction.

Charitable remainder trusts. There is a very powerful estate planning tool that may enable you to reduce your liability for income and estate taxes and diversify your assets in a tax-advantaged manner. It is called a charitable remainder trust ("CRT"). It provides the ability to have a charitable contribution deduction, diversify highly appreciated holdings without current tax recognition and receive payments to you for your life. A CRT is a very complex arrangement, but it is also an invaluable planning tool in the right circumstances.

REDUCE/MANAGE YOUR AMT TAX

Alternative Minimum Tax ("AMT") is a separate and complex tax that impacts individuals at certain higher levels of income in conjunction with certain types of deductions. While beyond the scope of this article, there are ways to reduce and manage the AMT tax. For example, prepaying state income taxes is an easy and effective way to reduce your federal income tax liability unless you are going to be subject to the AMT tax. AMT implications occur if you have incentive stock options; pass-through's with AMT differences/preference items or if you invested in tax-free private activity bonds. As part of your year end planning, the accountants at Newburg & Company review the impact of AMT.

MAXIMIZE RETIREMENT CONTRIBUTIONS

Retirement plans. By contributing to retirement plans you reduce your adjusted gross income and save taxes. Maximize your contribution to your 401(k), 403(b) or 457(b) plan and remember individuals over 50 have higher limits. If you are self-employed and have not done so, you can set up a self-employed retirement plan. Is your own defined benefit plan an option for you? Significant current taxes can be saved.

Make a deductible IRA contribution, even if you do not work. As a general rule, you cannot make a deductible IRA contribution unless you have wages or other earned income. However, an exception applies when one spouse is the breadwinner while the other manages the home. For 2009, you can make a deductible IRA contribution of up to \$5,000 (\$6,000 if you are 50 or over) even if you have no earned income. Even if your spouse is covered by an employer-provided retirement plan you can still make a fully deductible IRA contribution as long as your joint AGI as specially computed doesn't exceed \$166,000. To be deductible for the 2009 tax year, the IRA contribution must be made no later than your tax return due date.

TAKE ADVANTAGE OF ALLOWABLE DEDUCTIONS

Congress passes laws allowing new deductions from time to time and some seemingly non-deductible expenses may be allowed.

Sales tax deduction for new car purchasers for 2009. New law allows taxpayers to deduct state and local sales taxes paid on the purchase of a new automobile, including light trucks, SUVs, motorcycles, and motor homes. The tax break phases out starting with taxpayers earning \$125,000 per year (\$250,000 for joint returns). The deduction is allowed to both those who itemize their deductions as well as to non-itemizers.

Deductible job-search expenses. *What are job hunting expenses?* Expenses of seeking new employment can encompass a broad range of items. Some of the more common expenses for which deductions have been allowed are:

- the cost of resumes, including postage for sending them to prospective employers;
- job counseling and referral fees;
- employment agency fees;
- telephone charges related to seeking new employment;
- local as well as out-of-town travel for interviews, to the extent not reimbursed by the prospective employer.

Claim a moving expense deduction because of your spouse's job. Job-related moving expenses (the cost of moving household goods and personal effects plus transportation and lodging en-route) are above-the-line deductions, which can be claimed even by non-itemizers. This write-off generally is available only if (1) you start a new job or business at the new location (or are transferred by your employer), and (2) the new job location is at least 50 miles farther from your old home than your old job was from your old home. Even if you do not individually qualify, you can still claim the write-off if your spouse does.

Write off the cost of a tutor as an education expense. You can deduct the cost of education that maintains or improves the skills required in your business or employment, but not costs to meet the minimum requirements of your trade or profession, or to qualify you for a new job. "Education" does not have to be of the classroom variety. For example, you are a sales executive who suddenly had to become an e-commerce expert. You hire a consultant to be your tutor and teach you everything you need to know. That cost is deductible as an education expense. But you can only claim it on Schedule A, Form 1040 as a miscellaneous itemized deduction. Such deductions can be claimed only to the extent their cumulative total of itemized deductions exceeds two percent (2%) of your AGI.

Home improvements may be medical expense deductions. Home improvements generally are not deductible. But a medical expense deduction may be claimed if you make a medically necessary home improvement, such as a lift or elevator for a handicapped person, or a therapy spa for an arthritis sufferer.

Please note that this is intended to be a summary of some of the tax planning considerations available. Depending on your particular situation, there may be a variety of additional planning options available. We encourage you to contact us to review your unique circumstances.