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'Tis the Season for Year-End Tax Planning

As we wait for final legislative guidance on the extension of current income tax rates and the estate tax, only a few weeks remain to implement some smart strategies that can minimize your 2010 tax bill or maximize your return. Depending on what happens in Washington in the next few weeks, particularly in regard to the extension of the Bush tax cuts, it may become necessary to revisit your plans. Meanwhile, we'd like to provide you with reminders and tips for both individuals and businesses. Not everything will apply to everyone. If you have questions or would like to discuss your particular situation, your KKAJ advisors are always ready to assist.

For Individuals

Capital Gains and Losses

Selling securities at a loss can reduce other capital gains, and a net loss of $3,000 may be used to offset other income. Remember to check last year's tax return for any losses of which you haven't taken full advantage, so you can carry them forward into this year.

If you decide to sell securities to realize a loss, you cannot make a "wash sale." That means you cannot purchase substantially identical assets within a 61-day period beginning 30 days prior to the loss sale and ending 30 days after the sale.

Because the top capital gains tax rate could rise to 20 percent in 2011, it might be wise to sell in 2010 if you have a gain. To avoid surprises, be aware that December trades are considered 2010 transactions even if the settlement date is January 2011. Further, remember that the capital gains rate on securities held for less than a year is higher than on securities held for longer periods.

If you're in the 10 or 15 percent tax bracket, your tax rate on capital gains and qualified dividends could be zero. This applies to single individuals whose taxable 2010 income is under $34,000, and to married couples filing jointly whose 2010 taxable income is under $68,000. If your income is higher, consider gifting appreciated stock to someone who is eligible for the zero percent rate, such as retired parents, who can sell the stock without paying capital gains tax. Let your KKAJ advisor help you plan carefully to make sure you avoid gift taxes.

You can defer income by selling an asset at a gain and collecting the proceeds over the next few years. However, consider the risk of financing the sale yourself, particularly in an economic climate where defaults are commonplace. Also, since capital gains rates may rise after 2010, it may be more cost-effective to report the entire gain this year.

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Defer or Accelerate?~

A common year-end tax planning strategy is to defer income from this year into future years, and to accelerate deductions from future years into this year. However, deferring income only makes sense if you expect your tax rate to be lower (or perhaps remain the same) next year. On the other hand, if your tax rate is likely to be higher next year, you might want to accelerate income into this year and defer deductions into next year.

Accelerating deductions into this year is particularly important if you anticipate qualifying for fewer deductions in 2011. Further, if you expect to qualify for the standard deduction in 2010 or 2011, it's most cost-effective to shift qualified expenditures into the year in which you will itemize your deductions. That way you can claim the "free" standard deduction in the other year. Similarly, if

you're going to pay the alternative minimum tax (AMT) in 2010 or 2011, shift your deductions into the year in which you itemize your deductions because the AMT allows for fewer deductions.

Tax Credits for Home Improvements and Alternative Fuel Vehicles

Certain energy-efficient home improvements (exterior doors and windows, HVAC systems, water heaters, insulation, etc.) qualify for a 30-percent tax credit. Note that the credit has a cumulative limit of $1,500, so if you claimed part of it in a prior year, you cannot get the full amount this year. Your purchase has to be completed before December 31st. The credit may not be continued in 2011, so take advantage of it while you can.

Tax credits available to purchasers of vehicles that use fuel-saving or alternative-fuel technologies vary by amount and type of vehicle. Check with the manufacturer to see what's available. Again, some of these credits may no longer be available in 2011, so strike while the iron is hot.

Healthcare

Consider making over-the-counter drug purchases this year because, pursuant to the new healthcare law, they can no longer be reimbursed from flex plans and health reimbursement arrangements (HRAs) in 2011.

You can deduct the contributions to a health savings account this year even if you do not use the monies to pay for medical expenses in 2010.

Charitable Contributions

If you have securities that have declined in value, you can sell them to realize a loss (within annual capital loss limitations), then gift the proceeds to a charitable organization to get a deduction. On the other hand, if you have securities that have appreciated in value, it makes more sense to donate them directly. That way, you can deduct their fair market value even though your basis in the security might be less.

If you charge a charitable contribution to a credit card, you can take the deduction right away even if you don't make payments on the card until next year. However, you cannot deduct the amount of a pledge to make a charitable contribution until you actually donate the money.

Retirement Planning

Individual retirement accounts (IRAs) and simplified employee pension plans (SEPs) can be funded any time by April 15, 2011 (or by the extended due date of your return in the case of a SEP) in order to qualify for a deduction. You may also qualify for a tax credit. Other types of retirement plans must be created before the end of 2010.

Converting a traditional IRA to a Roth IRA results in taxable income. However, if you're thinking of converting, this is a good time to do so because for 2010 only, your taxable income can be split 50-50 between 2011 and 2012. On the other hand, since tax rates may increase in 2011, you may want to report all the income in 2010, especially if you have other losses that could offset this income.

More and more retirees are becoming subject to the Alternative Minimum Tax (AMT), particularly those with large capital gains, high itemized deductions (other than charitable contributions) or high personal exemptions. Your KKAJ advisor can help you determine if you'll be subject to the AMT and plan accordingly.

Estate and Gift Taxes

If you would like to reduce your taxable estate, you can gift up to $13,000 in 2010 without paying federal gift taxes. Married couples can take advantage of the gift-splitting rules by gifting up to $26,000 per recipient without paying federal gift taxes. For example, if you have two children, you and your spouse can give each child $26,000 in December and another $26,000 in January.

Passive Activities

There are limits to losses you can claim from passive activities (such as real estate or a business in which you do not actively participate). However, the losses may be carried over into future years provided you also have passive income from the activity. If you don't have enough passive income for 2010, you can only apply the "suspended loss" to this tax year if you sell the real estate or dispose of the activity.

For the Self-Employed

If you are self-employed on a cash basis and would like to defer some income to 2011, consider sending out bills for 2010 work late in the month so your customers pay them in 2011. If, on the other hand, you would like to increase your 2010 income, consider offering discounts to customers who prepay this year for 2011 work.

If you have earned income from self-employment, health insurance is deductible even if you don't itemize. This may change in the future, so take advantage of it while you can by buying health insurance this year. Further, according to the Small Business Jobs Act of 2010, which became law on September 27, 2010, the purchase of self-employed health insurance reduces both your income tax and your self-employment tax. Long-term care insurance also qualifies.

For Businesses

Section 179 Deduction

Internal Revenue Code Section 179 allows the expensing of all or a portion of certain qualifying assets in the year placed in service rather than depreciating the asset over several years. For 2010, the amount available to expense is $500,000. For qualifying investments in excess of $2 million, a dollar-for-dollar reduction of the $500,000 expense is permissible.

In the past, the asset to be expensed under Section 179 had to be personal property used in an active business-not real property. Now, thanks to the Small Business Jobs Act of 2010, you can expense up to $250,000 of qualified real property, such as certain interior improvements to leasehold, restaurant and retail properties. You have to occupy the property and it must have been in service for over three years.

Bonus depreciation rules have been extended for one year. That means property that does not qualify for a Section 179 write-off may qualify for an increased depreciation deduction of 50 percent of its cost if placed in service by December 31, 2010. The property has to be new; be water utility property or certain software; have a modified accelerated cost recovery system (MACRS) recovery period of 20 years or less; and be qualified leasehold improvement property.

Payroll-Related Benefits

The Hiring Incentives to Restore Employment (HIRE) Act allows a payroll tax holiday for wages paid to qualified new hires. Specifically, you do not need to pay the employer share of Social Security taxes on wages paid in 2010. Qualified new hires are people who began employment with you after February 3, 2010 and before January 1, 2011, who were previously unemployed, and who were not hired to replace other employees.

The 2010 healthcare act provides that an eligible small employer (ESE) may receive a tax credit to purchase health insurance for its employees. To qualify, the employer has to pay at least 50 percent of the premium cost for employees and have no more than 25 full-time equivalent employees employed during the year. In addition, the average of your employees' annual full-time equivalent wages cannot exceed $50,000.

Corporate Dividends

Every C corporation dreads the "double tax"-profits are taxed at the corporate level and then dividends paid out to shareholders are taxed as well. However, consider that the maximum tax rate for qualified dividends is currently 15 percent. If you need to pay out dividends, consider minimizing your damage now rather than waiting until the rate increases to 20 percent or more.

Plan Ahead Next Year

The holiday season is a busy one, and tax planning may not be first on the list of things to do. Unfortunately, it's unavoidable if you'd rather spend money on your family and friends than give it to the tax man. If you would like more details about the points mentioned in this update or any other aspect of tax planning, please contact a KKAJ tax and accounting professional at 818.848.5585. We can also help you get an early start on next year's tax planning to free up your time in December 2011.

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