Dear Client:

Year-end tax planning could be especially productive this year because timely action can nail down a host of tax breaks that won't be around next year unless Congress acts to extend them. These include, for individuals: the option to deduct state and local sales and use taxes instead of state income taxes; the standard or itemized deduction for state sales tax and excise tax on the purchase of motor vehicles; the above-the-line deduction for qualified higher education expenses; tax-free distributions by those age 70 1/2 or older from IRAs for charitable purposes; and the $8,000 first-time homebuyer credit (expires for purchases after Nov. 30, 2009). For businesses, tax breaks that are available through the end of this year but won't be around next year unless Congress acts include: 50% bonus first year depreciation for most new machinery, equipment and software; an extraordinarily high $250,000 expensing limitation; the research tax credit; the five-year writeoff for most farm equipment; and the 15-year writeoff for qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements. Finally, without Congressional “extender” legislation (which has come at the eleventh hour for several years), alternative minimum tax (AMT) exemption amounts for individuals are scheduled to drop drastically next year, and most nonrefundable personal credits won't be available to offset the AMT.

High-income-earners have other factors to keep in mind when mapping out year-end plans. Many observers expect top tax rates on ordinary income to increase after 2010, making long-term deferral of income less appealing. Long-term capital gains rates could go up as well, so it may pay for some to take large profits this year instead of a few years down the road. On the other hand, the solid good news high-income-earners have to look forward to next year is that there no longer will be an income based reduction of most itemized deductions, nor will there be a phaseout of personal exemptions. Additionally, traditional IRA to Roth IRA conversions will be allowed regardless of a taxpayer's income.

We have compiled a checklist of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you (or a family member) will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

•Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year. Don't forget that you can set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.

•If you become eligible to make health savings account (HSA) contributions in December of this year, you can make a full year's worth of deductible HSA contributions for 2009.

•Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.

•Postpone income until 2010 and accelerate deductions into 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, higher education tax credits, the above-the-line deduction for higher-education expenses, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2009. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year.

•If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2009.

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

•If you own an interest in a partnership or S corporation you may need to increase your basis in the entity so you can deduct a loss from it for this year.

•Consider using a credit card to prepay expenses that can generate deductions for this year.

•If you expect to owe state and local income taxes when you file your return next year, consider asking 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 2010 if doing so won't create an AMT problem (see below).

•Estimate the effect of any year-end planning moves on the alternative minimum tax (AMT) for 2009, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes on your residence, state income taxes (or state sales tax if you elect this deduction option), miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes. As a result, in some cases, deductions should be deferred rather than accelerated to keep them from being lost because of the AMT.

•Those facing a penalty for underpayment of federal estimated tax may be able to eliminate or reduce it by increasing their withholding.

•Accelerate big ticket purchases into 2009 in order to assure a deduction for sales taxes on the purchases if you will elect to claim a state and local general sales tax deduction instead of a state and local income tax deduction.

•If you are planning to buy a car, do so before year-end in order to nail down a deduction for state sales tax and excise tax on the purchase.

•You may be able to save taxes this year and next by applying a bunching strategy to “miscellaneous” itemized deductions, medical expenses and other itemized deductions.

•If you are a homeowner, make energy saving improvements to the residence, such as putting in extra insulation or installing energy saving windows, and qualify for a tax credit. Additional, substantial tax credits are available for installing energy generating equipment (such as solar electric panels or solar hot water heaters) to your home.

•If you or a family member are thinking of becoming a first-time homebuyer, make the purchase before Dec. 1, 2009, in order to qualify for an up-to-$8,000 credit.

•You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.

•You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.

•Businesses should consider making expenditures that qualify for the business property expensing option, which is up to $250,000 for assets bought and placed in service this year; the maximum expensing amount will drop to $134,000 for assets bought and placed in service next year (higher expensing amounts apply in certain specialized situations). Businesses also should consider making expenditures that qualify for 50% bonus first year depreciation if bought and placed in service this year. This bonus writeoff generally won't be available next year.

•If you are self-employed and haven't done so yet, set up a self-employed retirement plan.

•You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. You can give $13,000 in 2009 to an unlimited number of individuals but you can't carry over unused exclusions from one year to the next.

•If you are age 70 1/2 or older, own IRAs (or Roth IRAs), and are thinking of making a charitable gift, consider arranging for the gift to be made directly by the IRA trustee. Such a transfer, if made before year-end, can achieve important tax savings.

•If you are age 70 1/2 or older and took a distribution from a retirement plan or IRA earlier this year, you may be able to avoid tax on the payout by rolling it over into an eligible retirement plan (including an IRA) before Dec. 1, 2009.

•If you are receiving Social Security benefits, there are a number of steps you can take to reduce or eliminate tax on your benefits.

•Consider extending your subscriptions to professional journals, paying union or professional dues, enrolling in (and paying tuition for) job-related courses, etc., to bunch into 2009 miscellaneous itemized deductions subject to the 2%-of-AGI floor.

•Depending on your particular situation, you may also want to consider deferring a debt-cancellation event until 2010, electing to deduct investment interest against capital gains, and disposing of a passive activity to allow you to deduct suspended losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Arthur S. Gunn, CPA