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2010 Year End Tax Planning Guide

Year end planning, which always involves some educated guesswork, is a bigger challenge this year than in past. The Bush tax cuts are a hot topic in Congress. As of the writing of this year end tax planning guide nothing has been signed into law and there is still a great deal of uncertainty as to what to expect for the tax years 2011 and 2012. However, many reliable sources are indicating that the Bush tax cuts will be extended for two years. What this means is that the federal income tax structure will remain relatively the same for 2011 and 2012.

With that said, we have compiled a checklist of actions that can help you save tax dollars if you act before year end. These moves may benefit you regardless of what the lame-duck Congress does on the major tax questions of the day. Not all actions will apply in your particular situation, but you 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.

Year End Moves for Individuals

- 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 cannot set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids (2010 is the last year that FSAs can be used for nonprescription drugs).
- 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. There are other aspects of the "wash sales" rules that should be considered. It may be advisable for us to meet to discuss year end trades you should consider making.
- Increase your withholding if you are facing a penalty for underpayment of federal estimated tax. Doing so may reduce or eliminate the penalty.
- Make energy saving improvements to your main home, such as putting in extra insulation or installing energy saving windows or buying and installing an energy efficient furnace, and qualify for a 30% tax credit up to \$1,500. The tax credit is limited to 30% of the first \$5,000 of expenditures for 2009 and 2010. Unless

Congress acts, this tax break won't be around after this year. Additionally, substantial tax credits are available for installing energy generating equipment (such as solar electric panels or solar hot water heaters) to your home. This break stays on the books through 2016.

- Convert your Traditional IRA into a Roth IRA if doing so is expected to produce better long-term tax results for you and your beneficiaries. Distributions from a Roth IRA can be tax-free, but the conversion will increase your adjusted gross income for 2010. However, you will have the choice of when to pay the tax on the conversion. You can either (1) pay the tax on the conversion when you file your 2010 return in 2011, or (2) pay half the tax on the conversion when you file your 2011 return in 2012, and the other half when you file your 2012 return in 2013. There are several considerations impacting the decision to convert to a Roth IRA. Please contact us if you are considering this.
- Take required minimum distributions (RMDs) from your IRA or 401 (k) plan (or other employer-sponsored retired plan) if you have reached age 70 1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. A temporary tax law change waived the RMD requirement for 2009 only, but the usual withdrawal rules apply in full force for 2010. So, individuals age 70 1/2 or older generally must take the required distribution amount out of their retirement account before the end of 2010 to avoid the penalty. If you turned age 70 1/2 in 2010, you can delay the required distribution to 2011, but if you do, you will have to take a double distribution in 2011-the amount required for 2010 plus the amount required for 2011. Think twice before delaying 2010 distributions to 2011-bunching income into 2011 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. If you do not need the distribution you may want to consider having the required minimum distribution go directly to a charity and therefore the money will not be taxable to you in current year.
- Make annual exclusion gifts before year end to save gift tax (and estate tax if it is reinstated). You can give \$13,000 in 2010 or 2011 to an unlimited number of individuals free of gift tax. Spousal gifts are unlimited. However, you can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.
- Increase your state income tax deduction by paying any state estimated tax payments by December 31. Taxpayers that are subject to the Alternative Minimum Tax (AMT) may not want to utilize this strategy. If you are not sure whether or not you are or will be subject to AMT please contact us. Taxpayers that expect to be in a higher tax bracket in the next year may not want to advantage of this opportunity.

- Prepay your January mortgage payment by December 31 to increase your mortgage interest deduction for 2010. This is because you will have made thirteen mortgage interest payments in 2010 as opposed to twelve. However, this will increase your deduction for this year only. Next year you will only have eleven months of the mortgage interest deduction unless you opt to prepay January again. Taxpayers that expect to be in a higher tax bracket in the next year may not want to advantage of this opportunity.
- Consider accelerating any charitable contributions you plan to make in 2011 in 2010. Also, consider donating any household items or articles of clothing by December 31 to maximize your charitable contributions for 2010. Taxpayers that expect to be in a higher tax bracket in the next year may not want to advantage of this opportunity.
- Virginia taxpayers should consider purchasing Virginia Land Preservation Credits. The Virginia Land Preservation Tax Credit program is a market based approach for Virginia individual and corporate income taxpayers to participate directly in conserving Virginia's farms, open spaces and other significant parcels of land. Easement donors and subsequent individual and corporate buyers of the tax credits use their credits to offset Virginia income tax liability dollar-for-dollar up to \$50,000 per year. Married and filing joint clients may offset \$100,000 annually. Many easement donors may not have sufficient Virginia income tax liability to use all of their credits and therefore sell them at a reduced price to other Virginia taxpayers. Virginia Land Preservation credits are generally discounted between 15-25% of the face value of the credit which allows the buyer to realize a tax savings when they utilize their credits on their Virginia tax return. Please contact us immediately if you would like more information or you would like to take advantage of this opportunity. All purchases must be made before December 31.

Year End Moves for Business Owners

- Hire a worker who has been unemployed for at least 60 days before year end if you are thinking of adding to payroll soon. Your business will be exempt from paying the employer's 6.2% share of the Social Security payroll tax on the formerly unemployed new-hire for the remainder of 2010. Plus, if you keep that formerly unemployed new-hire on the payroll for a continuous 52 weeks, your business will be eligible for a nonrefundable tax credit of up-to-\$1,000 after the 52-week threshold is reached. This credit will be taken on the business's 2011 tax return. In order to be eligible, the formerly unemployed new-hire's pay in the second 26-week period must be at least 80% of the pay in the first 26-week period.

- Put new business equipment and machinery in service before year end to qualify for the 50% bonus first-year depreciation allowance. Unless Congress acts, this bonus depreciation allowance generally won't be available for property placed in service after 2010. (Certain specialized assets may, however, be placed in service in 2011)
- Make expenses qualifying for the \$500,000 business property expensing option. The maximum amount you can expense for a tax year beginning in 2010 is \$500,000 of the cost of qualifying property placed in service for that tax year. The \$500,000 amount is reduced by the amount by which the cost of qualifying property placed in service during 2010 exceeds \$2 million. Also, within the overall \$500,000 expensing limit, you can expense up to \$250,000 of qualified real property (certain qualifying leasehold improvements, restaurant property, and retail improvements). Note that at tax return time, you can choose not to use expensing (or bonus depreciation) for 2010 assets. This is something to consider if tax rates go up for 2011 and future years, and you'd rather have more deductions after 2010 than for 2010.
- Set up a self-employed retirement plan if you are self-employed and haven't done so yet.
- Increase your basis in a partnership or S corporation if doing so will enable you to deduct a loss from it for this year. A partner's share of partnership losses is deductible only to the extent of his partnership basis as of the end of the partnership year in which the loss occurs. An S corporation shareholder can deduct his pro-rata share of an S corporation's losses only to the extent of the total of his basis in (a) his S corporation stock, and (b) debt owed to him by the S corporation.
- Consider whether to defer cancellation of debt (COD) income from the reacquisition of an applicable debt instrument in 2010. The business can elect to have the COD income included in gross income ratably over five tax years beginning with the fourth tax year following the tax year in which the repurchase occurs (i.e., beginning with 2014).
- Cash basis taxpayers may want to accelerate paying vendors and other expenses before December 31.

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.