

2009 Year End Tax Planning

December 2009

As the end of the year approaches, it is a good time to think about both tax planning and a year-end check-up on all aspects of your personal finances.

Action taken between now and December 31 may help to reduce the burden of 2009 taxes, and also to keep in the forefront the progress of your personal goals regarding the creation, preservation, and transition of your net worth.

When planning for the long-term, the interrelationship between income tax strategies, estate and gift strategies, and investment strategies can make financial decisions difficult. We recommend working with our team of advisors for comprehensive planning that focuses on your goals by looking at all aspects of your personal balance sheet, now and in the future.

Good income tax, estate tax and investment planning is personalized for your circumstances. Our team of advisors is available to assist you in building a long-term wealth plan that helps you achieve your goals and minimize tax effects.

As we approach year-end, Congress is still working on significant legislation. In particular, health care reform and other potential changes to the tax code are likely to be considered during the month of December. These potential changes may make it more difficult to predict the future and plan.

Before doing any planning based on this publication, we recommend that your Moss Adams advisor be consulted to ensure that you are aware of the most up-to-date information regarding potential changes in the tax code.

Changes in Tax Rates Expected Due to Health Care Reform

Congress is currently grappling with the issue of health care reform and how to pay for it.

The House of Representatives in early November passed legislation that would impose a 5.4% surtax on modified adjusted gross income of \$1 million or more for couples and \$500,000 for non-married individual taxpayers. The surtax would be effective beginning in 2011.

The Senate's version of health care legislation is still being worked on. The current version of the proposed Senate bill would raise payroll taxes by 0.5% for individuals earning more than \$200,000 (\$250,000 for married couples). The payroll tax increase would be effective beginning in 2013. In addition, an excise tax of 40% would apply beginning in 2013 to the cost of health coverage in excess of \$8,500 (singles) and \$23,000 (families). A 5% excise tax on cosmetic surgery would apply beginning in 2010.

Beginning in 2011, employers would be required to report the value of health care coverage on employee W-2s for information purposes. Other tax provisions are also contained in the Senate bill.

From a procedural perspective, if the Senate passes health care legislation, a conference committee would meet to iron out the differences between the two different versions of the bills. It is highly likely that changes will be made to the tax aspects of the legislation before final passage occurs.

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Changes in Income Tax Rates Expected in 2011 or Earlier

When the Bush tax cuts on income taxes were enacted in 2001, they were temporary and set to expire in 2011 assuming the Congress did nothing.

The 2001 legislation caused the highest income tax bracket to drop from 39.6% to 35%. The next highest bracket fell from 36% to 33%. Other brackets experienced similar changes.

Tax legislation passed under the Bush administration also lowered the long-term capital gains tax from 20% to 15%. This rate is also scheduled to "sunset" after 2010 and goes back to 20%, assuming the Congress does nothing to extend it.

Additionally, the rate on qualified dividends was lowered to 15%. If the Congress does nothing, beginning in 2011 dividends will be taxed at a taxpayer's ordinary rate instead of the 15% tax rate.

While it is difficult to predict what the Congress will do, many commentators believe that higher bracket taxpayers should plan for potential tax rate increases in 2011 and assume that the Congress will let these tax rate increases occur without a vote as permitted by the 2001 legislation.

Potential Estate and Gift Tax Changes for 2010

Back in 2001, the Congress also made changes to the estate and gift code, which resulted in a gradual increase in the amount of assets that were not subject to the federal estate tax (currently at \$3.5 million). As part of the legislation, there was a one-year "repeal" of the federal estate tax—in 2010.

It is widely expected that Congress will extend the current law exemption from the estate tax (\$3.5 million) with a one year "patch" leaving any more substantive changes to be considered by Congress next year.

Conversion to Roth IRA Opportunity in 2010

Income limits preventing higher-income taxpayers from converting traditional IRAs to Roth IRAs are waived beginning in 2010. The value of the account, less any associated cost basis (from making non-deductible contributions in prior years, for example) is subject to tax at ordinary rates.

The normal rule is that taxpayers will pay tax on the conversion with half the income subject to tax in 2011 and the other half subject to tax in 2012 (watch out for potentially higher tax rates starting in 2011). An election to tax the conversion income in 2010 is available.

For most individuals, a Roth conversion doesn't make sense because it's not good to pay tax earlier than it would otherwise be due. There are, however, some fact patterns where thinking about a Roth conversion may be warranted:

- Business losses exist to shelter the conversion income in 2010;
- The possibility of higher tax rates in 2011 and later years lessen the current pain of paying tax on the conversion;
- Using the IRA as a wealth transfer vehicle for family members, where the income tax cost of conversion is outweighed by the future financial impact to family members;
- Lower current IRA values due to stock market declines make the cost of conversion relatively low.

Moss Adams can help determine whether a Roth IRA conversion in 2010 is right for you.

The following checklist can serve as a reminder of new (and old) tax planning concepts to keep in mind this month.

► Individuals and Family Tax Planning Checklist

1. Personal Income Tax

- ☑ *New Carryback Rules Apply to Net Operating Losses*
 - Tax legislation passed in November 2009 permits net operating losses generated in 2008 and 2009 to be carried back as far as 5 years, up from a 2-year carryback period.
- ☑ As a reminder, required minimum distributions from individual retirement accounts are waived for 2009.
- ☑ Alternative Minimum Tax ("AMT") "warning signs" include large deductions for state income and real estate taxes, large miscellaneous itemized deductions, and sizable capital gains. A tax projection can illustrate how AMT affects you. Tax planning when subject to the AMT requires careful analysis, so it's important to know if it may apply.
- ☑ *Income Planning*
 - Defer or accelerate income to maximize the use of deductions, losses, and consider expected income tax rates between the 2009 and 2010 tax years. For longer term planning, take into account expected income tax rates for 2011 and later years.
- ☑ *Deduction Planning*
 - Accelerate or defer expenses and deductions to maximize the use of deductions and consider expected income tax rates between the 2009 and 2010 tax years. As part of your decision-making, take into account expected income tax rates for 2011 and later years.
 - Bunch medical expenses into tax years when they will exceed 7.5% of adjusted gross income.
 - State income taxes: We can help you determine if you will receive a benefit from paying a fourth quarter state estimated tax payment in December 2009 or January 2010. Your exposure to the alternative minimum tax may be a key factor to consider.
 - Vehicle sales tax deduction: Taxpayers may deduct sales tax paid on a new vehicle purchased February 17, 2009 through December 31, 2009. This deduction is available to taxpayers who do not itemize and is in addition to the standard deduction. For taxpayers who itemize, the deduction is in lieu of state income taxes. The vehicle tax deduction is phased out for higher bracket taxpayers starting at \$250,000 MFJ, \$125,000 Others. Only taxes on the cost of a vehicle up to \$49,500 may be deducted.
- ☑ *Charitable Contribution Planning*
 - If you have appreciated investment assets that you've held for more than a year, give the appreciated property to the charity instead of cash. You'll get a

deduction for the fair market value, and the charity doesn't have to pay the capital gains tax.

- Depreciated investment assets should be sold first, and the cash donated to charity. That way you'll get the benefit of the capital loss.
- Clean out your closets and look through the basement and attic for donations of clothing and household goods (in good working order). Get them to the charity before the end of the year, and you'll save on taxes in April. Prepare an itemized list of what you're donating. The charity will provide you with an overall receipt for the donation of clothing and household goods, but you'll have to keep track of what was given and assign the value.
- Year-end charitable contributions may be made on your credit card, but the gift must be processed and charged to the card by December 31 in order to be deductible on the 2009 tax return. Checks to charities must be written and postmarked by December 31 for a 2009 deduction.
- Keep in your tax files the "thank you" letters from charities for contributions of \$250 or more in order to maintain required records of your giving.

Capital Gain and Capital Loss Planning

- The timing of the sale of assets can be used to minimize realized gains and take advantage of realized losses when the proper rules are applied.
- Taxpayers thinking about the sale of assets that would produce large amounts of long-term capital gains should be wary of the potential changes in the long-term capital gains tax rate (*discussed above*).
- Taxpayers contemplating an installment sale, in which taxes are paid over time as payments are received, should consider electing out of installment sale treatment to take advantage of today's historically low 15% federal capital gains tax rate. Modeling the "what-ifs" can help make a decision how to proceed based on individual facts and circumstances.

Tax Credit for First-Time Home Buyers (Second-Time Buyers, Too!)

- To be eligible for the original version of the tax credit, the home must have been purchased by a first-timer before December 1, 2009. The amount of the credit is limited to \$8,000, and phases out once certain income levels are reached (\$150,000 MFJ, \$75,000 Others). A special rule permits an amended 2008 return to be filed to claim the credit, even if the home was purchased in 2009. Recapture of this credit occurs if the home is not used as a principal residence for at least 36 months.
- A revised version of the tax credit applies to homes purchased by first-timers after November 6, 2009 through April 30, 2010 or under contract as of April 30, 2010 and closed by June 30, 2010. The amount of the credit is also \$8,000, but the phase out of this credit starts at higher income levels (\$225,000 MFJ, \$125,000 Others). The maximum home price eligible for the credit is \$800,000.
- A special up-to-\$6,500 tax credit is available for non-first time homebuyers if they buy after November 6, 2009 and before April 30, 2010 (or are under contract as of April 30, 2010 and closed by June 30, 2010) and have lived in their prior residence for any 5 consecutive years in the 8 year period ending on the date of purchase of a new residence. This may be of interest to "empty nesters" or older couples thinking about downsizing. Eligibility for this tax credit

begins to phase out for incomes of \$225,000 MFJ and \$125,000 Others. The maximum home price eligible for the credit is \$800,000. There is no requirement that the first residence be sold in order to be eligible for the replacement home credit. Sellers are also able to claim the home sale gain exclusion (\$500,000 MFJ, \$250,000 Others) if they qualify for it.

Sale of Primary Residence

- Starting in 2009, the use of a taxpayer's primary residence has become important in maximizing the capital gains exclusion when a primary residence is sold. The capital gains exclusion, currently \$250,000 for single taxpayers and \$500,000 for married taxpayers filing jointly, is proportionately reduced for those years that a primary residence is used for any purpose other than as a primary residence, e.g., as a vacation home, investment or rental property, or in a trade or business (such as a home office). If you're thinking about selling your home and want to take advantage of the full amount of the exclusion, keep this in mind.

College Education Tax Credits Changed for 2009 and 2010

- The HOPE Credit is now called the American Opportunity Tax Credit and is available for the first four years of education (rather than two as in past years). Forty percent of the HOPE credit is refundable and the types of expenditures that qualify have been expanded to include course materials even if they are not purchased from the educational institution as a condition of enrollment.

2. Retirement Planning

Is the Right Retirement Plan in Place for the Future?

- Work with your benefits consultant and your tax advisor to ensure that the "right" retirement plan is in place for your closely-held business or self-employment income. Consider selecting a plan that allows for deductible retirement contributions for owner-employees in light of expected tax rate increases in future years.
- Certain plans, such as Keogh plans, are required to be established by year-end, even though contributions don't need to be made by that time.

Roth IRA Conversion Opportunity in 2010

- Taxpayers who in the past were precluded from converting traditional IRAs to Roth IRAs may now do so beginning in 2010. Special rules may apply to defer any related tax to 2011 and 2012.

401(k) Plan Proposal for Smaller Companies (<100 Employees)

- A 401(k) plan proposal from Moss Adams Wealth Advisors, a registered investment advisor, lets the fiduciary examine the plan's current operating costs and evaluate the plan's present-day investment options, thereby helping to meet their fiduciary obligations.

3. Charitable Giving

- Individuals Age 70-1/2 or Older Can Transfer up to \$100,000 from IRAs to Qualifying Charities*
 - When IRA account values were high and minimum distributions were required, this opportunity made sense for some taxpayers. In light of the 2009 waiver for minimum required distributions, this opportunity may be worth considering in 2010 and future years (if the provision in the law is extended).
- Timing of Larger Charitable Gifts*
 - Upper-bracket taxpayers may find their marginal tax rates to be higher in 2010 than in 2009. As a result, consider whether larger charitable contributions should be made in early 2010 versus year-end 2009.
- Charitable Giving as Part of an Overall Estate Plan*
 - Incorporate your charitable desires within a comprehensive, long-term estate plan/legacy strategy, taking into account the various tax and cash-flow efficient ways to structure charitable gifts.

4. Investment Management

- In the future, there are possible tax rate changes for long-term capital gains, qualified dividends and ordinary income. All will have an impact on your investments and you should work closely with your tax advisor and investment advisor to receive coordinated advice.
- Installment Sale Tax Planning*
 - In light of potentially higher capital gains tax rates in 2010, taxpayers should consider whether to elect out of installment sale treatment for sales of closely held stock or real estate. This could enable 2009 installment sale gains to be taxed at today's 15% federal long-term capital gains tax rate as opposed to future years' unknown tax rates (possibly 20%) on long-term capital gains.
- Tax Loss Harvesting/Tax Gain Sheltering.* Work with your investment advisor to minimize net capital gains and take advantage of any inherent capital losses that may be in your account.
 - For those with large year-to-date capital gains or losses, year-end is a critical time to review opportunities for offsetting gains with losses to save taxes.
 - If you have recognized gains to date, consider the sale of assets with built-in losses to offset the gains.
 - It may make sense to recognize gains before year-end to offset against losses and use the "specific ID method" to minimize taxes.
 - Beware of the 30-day wash sale rules.
- Investment Strategy*
 - In light of recent economic performance, review your investment strategy to determine that it is consistent with your personal goals.
 - Re-evaluate tax-exempt yields versus taxable yields in light of current market conditions and potential changes in income tax rates.

- ☑ *Prepare for Sweeping Changes in Information Return Reporting*
 - By 2011, taxpayers will be required to designate (on an account-by-account basis) the method of calculating gains. Once the choice is made, the method will apply to all stocks in the account. Significant planning will have to be done in advance of the effective date to ensure that the "right security" is in the "right account" with the "right method" in planning for the recognition of capital gains.

5. Personal Financial Planning

- ☑ *Create a Roadmap and Start the Process*
 - For those without a clear set of long-term and short-term personal financial goals, take the time to create a personal financial plan and begin to monitor your progress towards those goals.
- ☑ *Update Existing Plans in Light of Recent Economic Performance*
 - The uncertainty due to the economic events of the last year is a good reason to update an existing personal financial plan and verify where you stand in relation to achieving your personal financial goals.

6. Estate & Gift Planning

- ☑ *Lifetime Gifts*
 - Maximize the use of the \$13,000 per recipient annual exclusion by giving assets that match your cash-flow needs and long-term estate planning goals. Remember that a spouse can also gift \$13,000 per recipient.
- ☑ *Develop or Update a Long-Term Estate Plan*
 - Understand your goals and the effect of federal and state (if applicable) estate taxes. You may wish to work with Moss Adams and your attorney to build a plan for addressing your cash flow needs, family needs and charitable desires.
 - After an estate plan has been developed, confirm that your assets are properly titled and the beneficiary designations are correct.

7. Insurance Management

- ☑ *Manage Your Life Insurance Assets*
 - Life insurance is a valuable asset and should be "managed," just like other asset holdings.
 - Tax law changes (such as those impacting "split dollar arrangements" used to pay for life insurance policies) should be reviewed with an insurance advisor and your tax advisor.
- ☑ *Changed Circumstances Create a Need for a Life Insurance Review*
 - Life insurance policies should be reviewed in accordance with current wealth management needs, transfer goals, and liquidity concerns.
- ☑ *Life Insurance Policies Need Review for Efficiency and Cost Effectiveness*
 - Check that existing policies are operating efficiently and as expected.
 - Lower premiums may be available to current policy holders.

► **Business Entities and Real Estate Tax Planning Checklist**

1. Flow-through Entities

- ☑ *New Asset Purchases*
 - Depreciation strategies can reduce AMT or they can be used to accelerate the deduction of costs as needed.
- ☑ *Entity Basis*
 - Maximize deductible losses by planning for adequate at-risk basis. If losses are anticipated in 2009 for your flow-through business, it is important to talk to your tax specialist before year-end to make sure you are in a position to take advantage of these losses to the fullest.

2. Entity Ownership Planning

- ☑ *Does your Buy-Sell Agreement do what you Expect it to?* Often, unanticipated outcomes are encountered both in drafting errors and with the passage of time.
 - Review agreements, funding structures, and insurance policies to ensure they are current and relevant. Your Buy-Sell Agreement should be reviewed every couple of years to ensure it functions as intended.
- ☑ *Plan Now for a Future Exit Strategy or Ownership Transition*
 - Comprehensive planning in advance for a potential exit strategy or ownership transition pays dividends both financially as well as in peace of mind. Coordinated planning develops a comprehensive strategy that focuses on business financial planning, ownership transition, management succession, personal financial planning and estate planning.
 - Our BOSS Evaluator diagnostic tool is designed to assess and analyze personal and business planning issues associated with respect to the transition of your business.
- ☑ *"C" Corporation to "S" Corporation Election May Save Future Taxes*
 - Consider making a change from "C" corporation status to "S" corporation status to avoid double taxation of income at the time of a future sale or liquidation, first at the corporate level and then again at the shareholder level.
 - After a conversion from "C" to "S," a ten-year lead time exists before a future sale or liquidation may completely escape double taxation.

3. Depreciable Real Estate & Business Equipment

- ☑ *Cost Segregation*
 - Accelerate the cash-flow benefit of depreciation via a detailed review of the depreciable components of a building by an integrated team of accountants and engineers. In many cases, a study by a Moss Adams Cost Segregation team documents the ability to take a large current-year tax deduction for depreciation. This can result in cash flow from tax savings. It is particularly appropriate to do a cost segregation study on buildings sold during 2009 or purchased within the last five years.

- ☑ *Increased Section 179 Depreciation Deduction Extended for 2009*
 - Section 179 depreciation deduction for qualifying assets acquired in 2009 remains at \$250,000. The depreciation deduction is decreased dollar-for-dollar for depreciable assets purchased over \$800,000. The deduction is scheduled to revert to \$125,000 for 2010, so it may make sense to schedule qualifying purchases before year-end.
- ☑ *Bonus Depreciation for 2009 Qualifying Purchases*
 - New equipment purchased in 2009 can be depreciated by 50% of its cost this year, and even further depreciated by taking the Modified Accelerated Recovery System percentage allowed on the remaining cost of the equipment.
- ☑ *New Tax Break for 2009 Farming Machinery and Equipment*
 - The Economic Rescue Bill provides that most machinery or equipment used in a “farming business” placed in service during 2009 will qualify for depreciation over five years instead of the usual seven-years.
- ☑ *15-year Depreciation for Leasehold Improvements, plus Special Rules for the Restaurant Industry*
 - Qualified leasehold improvements placed in service in 2009 can be depreciated over 15 years if they meet certain requirements.
 - In 2009, qualified restaurant property, including improvements and newly constructed buildings are also eligible for the 15-year life, and have much less stringent requirements than the qualified leasehold improvements mentioned above.

4. Research and Development

- ☑ Companies that develop new or improved products or processes may be able to benefit from the research and development tax credit incentives. The research tax credit is a dollar-for-dollar tax credit against taxes owed or taxes paid.

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