

December 17, 2009

Tax Planning for a Happy New Year

As the end of the year approaches, it is a good time to consider actions that may lower your tax bill this year and possibly next year as well. Year-end tax planning could be especially beneficial this year because several tax breaks will not be around next year unless Congress acts to extend them.

In addition, high-income earners should consider that top income tax and capital gains tax rates are scheduled to increase after 2010; this will make long-term deferral of ordinary income less appealing, and it may also be advantageous to take large profits this year or next year instead of a few years down the road. In addition, there no longer will be an income-based reduction of most itemized deductions next year (but the good news is that there will no longer be a phase out of personal exemptions, and, in 2010, traditional IRA to Roth IRA conversions will be allowed regardless of a taxpayer's income).

Low interest rates continue to provide taxpayers with unique opportunities to transfer wealth and reduce gift, estate, and generation-skipping transfer taxes. Clients can shift future appreciation of assets to younger generations using such techniques as: grantor retained annuity trusts (or GRATs), low interest loans to family members, installment sales to grantor trusts, charitable lead trusts, and family limited partnerships.

The following are examples of actions based on current tax rules that may also reduce taxes, if you act **before** year end:

- Make health savings account (HSA) contributions this year (you can make a full year's worth of deductible HSA contributions for 2009 even if you became eligible in December 2009).
- Realize losses on stock (and if you want to substantially preserve your investment position you can consider buying it back more than 30 days later).
- If you anticipate that your net income will decrease in 2010, postpone income until 2010 and accelerate deductions into 2009 to lower your 2009 tax bill (for example, by prepaying in 2009 state and local taxes due in 2010; and if cash is short, consider using a credit card to prepay in 2009 expenses (of course, weighing interest charges with benefits of tax planning); conversely, if you anticipate that your net income will increase in 2010, accelerate income into 2009 and delay non-expiring deductions until 2010).
- Convert a traditional IRA to a Roth IRA.
- Increase your basis in a partnership or S corporation if necessary to allow you to deduct a loss from it for this year.
- Accelerate big ticket purchases into 2009 (such as a car or appliances) 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).
- Pay contested taxes to be able to deduct them this year while continuing to contest them next year (weighing tax planning with litigation strategy of paying the contested taxes).
- Settle an insurance or damage claim to maximize your casualty loss deduction this year.
- Businesses can make expenditures that qualify for the business property expensing option (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.

- Businesses are allowed an increased expensing option under Code Sec. 179, a 50 percent bonus first-year depreciation write-off for most new machinery and equipment placed into service this year, and a reinstated research credit for 2009. This bonus write-off generally will not be available next year.
- Self-employed individuals should consider creating a self-employed retirement plan.
- Required minimum distributions from certain defined contribution plans (401(k) plans) and IRAs are suspended for 2009.
- If you are at least 70½ and required to take a minimum distribution from an IRA before year end, you can direct your trustee to distribute up to \$100,000 from your IRA directly to a qualified charity without income tax on the amount. You will not have to include the amount passing to charity in your income (up to the \$100,000 limitation) but will not be allowed a separate charitable deduction for that amount either.
- Consider deferring a debt-cancellation event until 2010, electing to deduct investment interest against capital gains, and disposing of interests in passive activities in order to allow a deduction for suspended losses.
- Take advantage on the annual gift tax exclusion. Each person is allowed to make a tax-free gift of up to \$13,000 per recipient each year (a husband and wife can give up to \$26,000 per recipient). This amount is not carried over if unused in 2009.
- Make gifts of stock depressed values to take maximum advantage of the annual gift tax exclusion (or sell depressed stock for a loss and make a gift of the cash; the cash can then be used by the recipient to repurchase the stock or make other investments).
- Congress has been contemplating legislation that would greatly reduce the discounts available to transfers of interests in family-owned businesses. Clients should consider making transfers of interests in closely-held family business entities this year.

In addition:

- Be sure to consider the alternative minimum tax ("AMT") in any planning you implement to make sure deductions otherwise available are not reduced or eliminated under the AMT.
- Eliminate or reduce a penalty for underpayment of estimated federal tax by increasing withholding for 2010.

The estate and generation-skipping tax exemptions are currently \$3,500,000. The estate and generation-skipping taxes are suspended in 2010, and the exemption amounts return to their pre-2001 level of \$1,000,000 in 2011. The current top rate for estate and generation-skipping transfer taxes is 45 percent; after the one-year repeal, these rates will return to their pre-2001 rates in 2011, with a maximum rate of 55 percent for taxable estates over \$3,000,000 (and 60 percent for a portion of an estate in excess of \$10,000,000).

With Congress focusing on health care legislation, it appears unlikely that an extension of estate tax and generation-skipping tax will occur; resulting in the suspension of those taxes for the beginning of 2010. Congress will most likely address the estate tax and generation-skipping tax again in 2010 with the intention that any legislation that is passed will be retroactive to January 1, 2010.

The strategies discussed above are not suited to every situation. If you have questions about any of the planning strategies discussed above, please do not hesitate to call any member of our group listed below to discuss how any of these strategies would affect your particular situation.

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