

# 2010 TAX PLANNING GUIDE

*as of February 1, 2010*



Trusted Advisors for Generations

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# TAX PLANNING TIPS FOR 2010

The last two years have been interesting, both from historic and planning aspects. In turbulent markets, even the best investment theories and planning practices are put to the test. These challenges have claimed some of the largest financial firms in the industry. However, Janney has weathered the storm. For over 175 years, our clients have looked to us as a source for education, advice and innovative solutions designed to help them to move toward their long-term goals.

From a planning perspective, this time has provided some unique and historically low-cost tax opportunities, particularly in the areas of gifting, contributions and establishing trusts. This guide can help you to determine some possible strategies to turn difficult markets into advantageous planning opportunities.

Several of the suggestions in this guide need to be implemented by year-end in order to be effective in a given year. Other planning techniques can sometimes be implemented after year-end. For example, tax-loss selling, the harvesting of capital losses as offsets to capital gains and possible carry-forwards, and the establishment of certain retirement plans, all need to be completed by December 31 of the year in which you intend to take the tax deduction. To help you with your planning, we have provided guidance so you can time your planning during the course of the year.

One of the key components to your tax planning should include a thorough review and update of your estate and financial plans, your will and trust documents, healthcare directives and beneficiary designations. Regulatory changes are expected in many areas of planning and keeping up to date with those regulations can be a worthwhile endeavor.

Your Janney Financial Consultant can work together with you and your tax and legal advisors to craft a plan that will serve your financial interests well in the coming years.

## Annual Tax Planning Methodologies

Often, tax planning involves paying your deductible expenses at a time of higher effective tax rates while deferring income and tax payments to periods of lower tax rates. In more practical terms, for year-end planning considerations, that means taking (or 'recognizing') expenses, deductions, credits and allowances during the present year while deferring sources of taxable income into next year. (See appendix for current tax rates and other useful tax information.)

If you, the taxpayer, are either close to retirement or experiencing a changing financial situation, there may be additional planning considerations to take into account.

Strategies that allow for the deferred payment of taxes may offer some advantages, although in some circumstances (such as the conversion of traditional IRAs to Roth IRAs) paying taxes upfront may be wiser. Although many people enjoy receiving a large tax refund, remember that, in most cases, a refund is no more than a pay back of money that the taxpayer loaned to the IRS, a loan that was interest-free. While the IRS never requires you to pay more taxes than are owed, calculations to determine taxes owed

can be complex and can have a significant impact on how much the taxpayer needs to pay and when the payments are due.

Tax planning can go a long way. While the basics of tax planning involve the shifting and timing of income sources or expenses, the Internal Revenue Code contains a number of rules to hinder the shifting of income and expenses. These include rules such as passive activity loss, requirements that use the accrual method of accounting and limitations on the deduction of investment interest.

Following are more specific details and tips about current issues in tax law that may be helpful. The bullets following the detailed descriptions identify current considerations with regard to each section:

## Income

Planning for income means looking for opportunities to generate income in ways that are tax-deferred, tax-free or taxed at favored rates. If it is anticipated that an investor's marginal tax rates will be lower in the future, timing of income flows may be used to push income recognition into the future. Likewise, if income tax rates are expected to be higher in future years, recognition of income in the present year would be recommended. Note that such changes in rates could come from a number of sources including possible regulatory changes to changes in personal circumstance. Care needs to be taken as deferring of income or acceleration of expenses may lead to Alternative Minimum Tax (AMT) problems.

- Under the American Recovery and Reinvestment Act, employers were instructed to withhold 6.2% less in federal income tax, up to \$400 per individual (\$800 for married filing jointly). As a result some tax payers, particularly married couples, may be under-withholding. If this describes your situation, be certain to check your tax withholding either with your tax advisor or by consulting the withholding calculator on the IRS website ([www.IRS.gov](http://www.IRS.gov)).

## Expenses

Planning for expenses focuses on harvesting expenses that may qualify for either an income tax deduction or, more ideally, a tax credit. Some deductions are only permitted if you are itemizing expenses as opposed to claiming the standard deduction. Itemizing deductions, using Schedule A, provides the taxpayer an opportunity to account for expenses in excess of the standard deduction, within guidelines. In short, itemized deductions are only valuable if sufficient deductions exceed the standard deduction. When calculating taxes, the decision of whether to itemize or take the standard deduction, need only be concerned with which method generates the largest overall deduction and therefore the largest tax benefit. For more information, please refer to the *Tax Planning Tips for Personal Expenditures and Other Items* section of this guide.

- If you are itemizing and do not anticipate being subject to the AMT, you can save on taxes by accelerating deductions into this year and deferring income until next year. For example, prepaying deductible state or local property taxes may help you to save, as can itemization when miscellaneous deductions exceed 2% of your adjusted gross income (AGI). See IRS *Publication 529 - Miscellaneous Deductions*, available on the IRS website for more details.

- Due to the fact that medical expenses are deductible only to the extent that they exceed 7.5% of your AGI, bunching expenses into a single year, if possible, may be helpful to your tax planning. Other medical expense-related ideas include: prepayment for your non-covered medical expenses or expenses for a qualifying adult dependent where you pay more than half their annual expenses.

## Charitable Contributions

Timing of payment for your charitable contributions can also provide a significant impact on your tax planning.

If you are planning to gift to charities, be certain to follow the IRS guidelines for documenting donations and consider gifting appreciated securities that you have held for at least one year. This will ensure that you receive the full value deduction of the donation and that you will not have to pay capital gains tax on the securities' appreciation. Please note that securities that are held for less than one year will only be permitted to be written off as to extent of cost basis, so plan charitable contributions accordingly.

## Tax Deductions

Accelerating deductions can help to lower your taxable income, which may lower your tax bracket and can result in your owing less tax in a given year. Some methods of doing so include:

- Making next year's charitable contributions in the current year;
- Prepaying deductible interest;
- Paying January's estimated tax installments in December instead of in the new year;
- Accelerating capital losses;
- Take advantage of available plans that may include Flexible Spending Accounts, Archer MSAs and cafeteria plans;
- Making any alimony payments due in January in December instead;
- Prepaying deductible education expenses owed next year in the current year.

## Tax Credits

A tax credit is a dollar-for-dollar reduction in your tax bill, usually as the result of a government-backed plan to promote investment or spending. It is not a reduction in taxable income, as in a deduction, but in the actual tax itself. Credits are therefore more valuable than deductions. For 2009-2010, the following tax credits are relatively new, notable and may be available:

- *Home Energy Tax Credit* – Qualified home improvements (including insulation, windows, and efficient heating/air conditioning units) can result in as much as a \$1,500 tax credit;
- *Computer purchases from a 529 plan* – 529 plans can be used to pay for a qualifying student's purchase of computer equipment and internet access;
- *Residential Efficient Property Credit (REEP)* – This credit is for installing solar electric and hot water systems, geothermal heat pumps, small wind turbines and fuel cell systems. (There are no dollar caps placed on this credit.);

- *Plug-in Electric Vehicle Credit* – Buyers of qualified vehicles can get a credit of \$2,500 – \$7,500 depending on battery capacity for the new vehicle and possibly another \$2,500 for lower-speed and 2-3 wheeled editions if bought between February 17, 2009 and January 1, 2012;
- *Expanded Tuition Credits* – The American Opportunity Credit (formally known as the Hope Credit) may allow for qualified tuition, fees and books of up to \$2,500 per student per year for single taxpayers up to \$80,000 (\$160,000 if filing jointly) and applies to the first four years of post-secondary education.

## Tax Burdens That Can Be a Trap

Many taxes that have been successfully passed over the years have targeted high income individuals. Unfortunately, because many of these taxes are not inflation-indexed, they can become traps for more moderate earners. Planning for these non-indexed taxes can be difficult, short of a political action. Included in this report are some suggestions, but we suggest you check with your tax advisor to see if you are or may become subject to any of the following:

- *Social Security Taxes* – In 1984, when Congress enacted a law for wealthy benefit recipients to pay taxes on benefits, only 10% of recipients were subject to the rule. Today, 33% of retirees are paying taxes on benefits and that number is expected to climb as high as 45% within a decade. If you have not paid taxes on your social security benefits in the past, you may have to in the future.
- *Capital Loss Carry-forwards* – Capital loss carry-forwards are carried as losses above \$3,000 into the future where those losses can help to reduce ordinary income in the future. At a 28% tax bracket, this can be a tax savings of \$840 but the baseline \$3,000 has not changed since 1978. If it had been indexed, that figure would now be closer to \$10,000 in today's dollars.
- *Alternative Minimum Tax (AMT)* – As income thresholds have not been adjusted for inflation, this separate tax system, which only affected 20,000 taxpayers when enacted in 1970, will now affect nearly 4.1 million taxpayers, including 800,000 taxpayers who made less than \$200,000 and 125,000 taxpayers who made less than \$100,000. Of note is that this tax, which originally targeted wealthy taxpayers, is paid by only 4.9% of taxpayers making \$1,000,000 or more.

What's new in the tax code for 2010 and later? Some of the critical planning changes include:

- Rules limiting itemized educational and personal exemptions do not apply in 2010, when adjusted gross income (AGI) exceeds certain thresholds. For 2009, the personal exemption phase-out began when AGI exceeded \$250,000 married filing jointly, \$208,500 HH, \$166,800 Single and \$125,100 married filing separately (*Code Sections 151(d)(3) and 86(g)*).
- The 15% and 0% long-term capital gain and qualified dividend rates are set to expire at the end of 2010. In 2011, a 20% maximum capital gains rate is anticipated to go into effect with dividends treated as ordinary income.
- Individual income tax rates are scheduled to increase after 2010, with the 10% rate disappearing and the top four pre-2001

rates of 28%, 31%, 36% and 39.6% reinstated. The 15% rate will be the lowest tax bracket.

- Beginning in 2010, the income maximum for conversion of a traditional IRA into a Roth IRA will no longer apply.
- Casualty loss rules have eased. Property casualty and theft losses are generally permitted if they exceed a dollar limitation per casualty or theft. They are permitted as an itemized deduction only to the extent that they exceed 10% of the individual AGI. For 2010, this limit is \$100. For 2009, it was \$500.
- Businesses which engage in manufacturing, construction and other domestic production activities may deduct 9% of qualified production activity income, up from 6% in 2009.
- Employers with less than 500 employees have a new retirement plan option starting in 2010 called the DB(k) plan.

## Alternative Minimum Tax

One provision of the tax code that must be taken into account when planning for taxes is the Alternative Minimum Tax (AMT), which can have serious consequences for taxpayers looking to minimize taxes through planning.

A completely separate tax system that was first implemented in 1970, the AMT was designed to run parallel to current tax code and to target high-income households that were paying relatively little in taxes. If the AMT-related taxes (also known as Tentative Minimum Taxes) are calculated to be more than the tax owed on your 1040, you may be required to pay the difference. In 1986, the AMT was expanded to include a different set of deductions (including: state, local and real estate taxes, long-term capital gains, accelerated depreciation, certain medical expenses, certain credits and deductions) that made the tax more relevant to moderate-earning households in high-tax states.

Since AMT can undo many efforts at tax planning, it is an important consideration. Because the threshold amounts used to determine whether AMT is owed have not been inflation-indexed, "bracket creep" has pulled more and more tax payers into owing AMT taxes. This has become a tax trap for middle-income taxpayers.

According to the Brookings Institute, a nonprofit public policy organization, in 1970, the AMT only affected 20,000 taxpayers. By 2010, absent changes in tax law, the AMT may impact more than 33 million taxpayers. In 2007, Brookings estimated that AMT was paid by approximately 4.1 million taxpayers. Without the AMT patch that was put into effect, 11.3 million taxpayers would have paid AMT in 2007 and for 2008, 26.8 million taxpayers. Brookings Institute also estimates that if some of the measures that make up the AMT calculation are not changed, in 2010, approximately 37% of households with income between \$50,000 to \$75,000 and 73% for households with income between \$75,000 and \$100,000 may owe some additional tax under AMT rules. The Tax Policy Center, a Brookings Institute agency, points out that one of the arguments against repealing the AMT is that it would be less expensive to repeal regular income tax (which would reduce revenues by 51.7 billion) than repealing the AMT (which would reduce revenues by \$87.6 billion).

*Even if you have not been subject to AMT in the past, it is very possible that you may become subject to it in the future.*

AMT rates are 26% and 28%, with exemptions phased out at higher income levels. Some of the sensitive items that appear on a tax return (listed below) include a number of the add-backs that are included when calculating whether you may become or are currently subject to AMT. If your marginal tax rate is higher than the 28% maximum AMT rates, you may benefit from accelerating income into a tax year when you would have had to pay AMT anyway but time-value-of-money considerations may impact your decision to do so as you will be paying taxes sooner rather than later.

Another planning consideration is to defer paying late-year expenses that are not deductible for AMT consideration if you may not be subject to AMT next year. Examples of such expenses may include investment fees and taxes.

Items that may be sensitive for the purpose of calculating AMT<sup>1</sup>:

- Accelerated depreciation;
- Depletion and deductions for intangible drilling costs;
- Exclusions for qualified small business stock;
- Foreign Tax Credit;
- Income from the exercise of Incentive Stock Options (ISOs);
- Intangible drilling costs;
- Installment sale income (certain types);
- Interest on home equity debt used for non-residential purposes;
- Interest on Private-Purpose Municipal Bonds<sup>2</sup>;
- Itemized tax deductions for tax, medical and miscellaneous expenses;
- Net operating and passive income or loss deductions;
- Refunds from state, local, property or sales taxes.

### Current Alternative Minimum Taxes:

For 2010, AMT exemptions will be \$33,750 (\$45,000 for married filing jointly or a qualifying widower, \$22,500 for married filing separately). By contrast, in 2009, the AMT exemption amount was increased to \$46,700 (\$70,950 for married filing jointly or qualifying widow(er) and \$35,475 for married filing separately). The current AMT exemption for a child whose unearned income is taxed at their parent's tax rate has increased to \$6,700.

Under Code section 26(a) (1), many personal non-refundable credits are allowed only to the extent that their aggregate amount does not exceed (if there is an excess) the taxpayer's regular tax liability over the tentative minimum tax for the taxable year.

While this may impede the taxpayer's ability to take some credits as an offset to AMT, there are still some credits that are permitted:

- Adoption Credit;
- Child Tax Credit;
- Low-income Savers Credit;
- Residential Energy Efficient Credit;
- American Opportunity Tax Credit;
- Qualified Electric Drive Motor Credit;

1. This list is not all-inclusive, but details some of the most common AMT sensitive considerations. For more details about the Alternative Minimum Tax may be found in IRS Form 6251 and its instruction booklet.

2. There is an exception for private activity bonds issued in 2009 and 2010. If you are considering purchasing a municipal bond, be certain to ask your Janney Montgomery Scott Financial Consultant if the interest on that bond may be subject to alternative minimum tax.

- Foreign Tax Credit;
- Non-depreciable property portion of the Alternate Motor Vehicle Credit.
- Qualified Plug-in Electric Vehicle Credit

## Tax Planning Tips for Your Family's Education

Next to retirement planning, education planning has traditionally been the highest priority of the individual investor. Planning for education can be an intricate task with little regulatory relief on the horizon. Finding the most tax-efficient means of saving and using the appropriate resources to maximize the long-term benefits of that saving is a critical component to meeting those education-related costs.

Generally, most available programs are subject to income limitations through phase-outs where the advantages are lessened above a certain level of income and then vanish above a second level of income. For taxpayers with significant income, there are few methods of relief available that are not phased out, but for parents with good credit who are U.S. citizens, U.S. nationals or permanent resident aliens, Federal PLUS loans are available at reasonable cost with flexible terms on payback period and timing. PLUS loans do require good credit on the part of the borrowers (the parents) as the loans are, effectively, unsecured but it is an important leveraging resource that may be available to you if most other programs are not.

There are opportunities for the individual to not only save effectively, but to employ important tax incentives to their advantage. The IRS publishes *Publication 970: Tax Benefits for Education* which is available on the IRS website to help guide taxpayers about the benefits and constraints available in current education programs. Following are education planning strategies:

### Qualified Tuition Programs (529)

Many states or educational institutions sponsor qualified tuition programs, known as 529 plans (named for their section of the tax code) that allow for non-deductible contributions that can grow tax-deferred to pay for qualified educational expenses. 529 plans have been in existence since 1996, but have come more into the public eye in recent years. The tax-free nature of qualified 529 distributions was made permanent with the Pension Protection Act of 2006.

- Everyone is eligible to take advantage of 529 plans and the amounts that can be contributed may be substantial. Neither age nor income is a limitation for donor or beneficiary. If you are considering going back to school, college or graduate school, for example, you can set up a savings plan for yourself;
- Unlike most plans, the donor of the assets maintains control of the account to decide what is withdrawn, when and for what purpose. Many plans may even let you withdraw assets for yourself if need be (though there may be taxes owed) but a key advantage is that the beneficiary of a 529 plan can be changed whenever necessary;

- The definition of which expenses are qualified includes tuition, fees, room and board (subject to limits and for students who are enrolled at least half-time), book and supplies as well as equipment (including computers, software and internet access fees);
- While you are not limited to your own state's qualified tuition program, plan benefits may be restricted to people who do not have state residency, or restrictions on the timing and use of distributions. What's more, there may be some restriction in a state-sponsored plan as to where the beneficiary can elect to go to school, but you would need to consult that plan's document to obtain such details;
- For financial aid, a 529-plan is considered an asset of the account owner, typically the parent, and withdrawals are not reported as income to student or parent so long as they are income tax free for federal taxes.

### Coverdell Education Savings Accounts

Coverdell Accounts offer similar benefits to 529 plans, but are currently limited to \$2,000 in annual contributions. This limit is expected to drop to \$500 in 2010. Coverdell contributors are also phased-out for taxpayers with modified adjusted gross income (AGI) between \$95,000 and \$110,000 (\$190,000 to 220,000 for joint filers). Following are key points regarding Coverdells:

- If you are considering using an existing education savings plan to pay for elementary or secondary school (K-12) for your child, consider doing so in 2010, as withdrawals for elementary and secondary schools will no longer be tax-free after 2010 if a Hope Credit, Lifetime Credit or Lifetime Learning Credit is claimed for the beneficiary;
- If different family members have established educational savings accounts for a single student, there may be a penalty owed if contributions exceed \$2,000 for that student;
- If the assets are not used for education, those assets will ultimately go to the person for whom they were meant, that is, the student who did not use them for tuition.

### Uniform Gift to Minors /Uniform Trust to Minor Custodial Accounts

UGMA/UTMA accounts have been in common usage for a long time. They are not necessarily education savings accounts (ESAs) but a simple way for a minor to own property when most states do not recognize a minor's right to contract. UGMAs are generally security accounts, with real property being limited to UTMAs. Current IRS regulations permit individuals to gift \$13,000 per year to anyone and the UGMA/UTMA can be a simple way to setup a receipt account without need of an attorney or trust. However, if an UGMA/UTMA account is utilized, there does need to be a designated custodian or trustee. Neither account requires a trust document as the terms and provisions of the accounts are set in state statute, not a formal trust document. Following are more specific details:

- Withdrawals in UGMAs/UTMAs can be initiated by the custodian for the benefit of the child, so long as the needs are

legitimate. These needs are not limited to college expenses, and may be used prior to the child reaching the age of majority or the age to attend college;

- Any unused money within the plan becomes the child's upon reaching the age of 18 (age of majority), though some states may vary. For UTMA accounts, some have a majority age of 21 and some may be as late as 25;
- Unlike 529 plans and Coverdells, there are no provisions in UGMA or UTMA accounts to change beneficiaries or to transfer assets between children;
- The UGMA/UTMA accounts are subject to "Kiddie Tax" rules, which would apply to full-time students who are age 19-23, whether they are claimed by the parent as a dependent unless the child provides half their support via earned income. Kiddie Tax is calculated and filed on Form 8615 on the student's tax return.

Additional credits and deductions available that have been established in the tax code are the following:

**For the tax years 2009 and 2010, the American Recovery and Reinvestment Act of 2009 expanded education related credits to parents and students, modifying the former Hope Credit and rebranding it as the American Opportunity Credit.**

The Lifetime Learning Credit is a separate credit that is distinct from the American Opportunity Credit in that it is non-refundable, applies to courses that are not necessarily related to the pursuit of a degree or educational credential and is available for students only taking a few classes. The AOC is only available for students enrolled at least half time for at least one academic period beginning during the tax year.

Last, the AOC is available only for 4 years per eligible student while the Lifetime Learning Credit is available for an unlimited number of years.

*Note that you cannot take the American Opportunity Credit and the Lifetime Learning Credit for the same student in the same year.*

## **The American Opportunity Tax Credit**

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The American Opportunity Tax Credit (AOC) may be claimed for tuition and certain fees paid for higher education in 2009 and 2010. The credit may be claimed for the first four years of post-secondary education. Previously, when this credit was known as the Hope Credit, this was only available for the first two years of post-secondary education.

- Formerly called the Hope Credit, this opportunity includes 100% of the first \$2,000 of qualifying expenses, 25% of the next \$2,000 up to a maximum credit of \$2,500 for each eligible student in your family. It must be taken in the year that the expense is paid, and the child must be a dependent. That is a \$700 increase in the AOC versus the previous Hope Credit.
- To be an eligible expense, the credit is for tuition for the first four years of college and related expenses. Previously, this credit was only available during the first two years of post-secondary education. This credit phases out with AGI between \$80,000 and \$90,000 single filer (\$160,000 and \$180,000 for

married filing jointly.) These phase-outs are estimated for 2010 and may be updated later in the year;

- One advantage to this credit is that it is calculated per child, not per return. If you have two children, for example, you can claim separate credits for each child, assuming income limits are not exceeded;
- Generally, 40% of the AOC is now a 'refundable' credit for most taxpayers, which means that up to \$1,000 is a final credit, even if no taxes are owed.
- For 2009, there may be an exception available to you if a credit is claimed for a student who attended school in a Midwestern disaster area. This may expand the available AOC credit to \$3,600.

## **Lifetime Learning Credit**

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This opportunity is available for each year of post secondary education, including college, graduate and eligible job training. It can be particularly advantageous for graduate students, students taking less than a full time educational schedule or those not necessarily pursuing a degree. Qualifications for the Lifetime Learning Credit do not include a degree program, may apply if only one class is taken and is available for a limited number of years.

The maximum credit is \$2,000 (20% up to 10,000 of qualified tuition and expenses) per taxpayer return, not per individual. Phase-outs for the Lifetime Learning credit occur between \$50,000 and \$60,000 single filer (\$100,000-\$120,000 for married filing jointly).

There are three conditions necessary to use the Lifetime Learning Credit:

- You pay qualified education expenses of higher education.
- You pay the education expenses for an eligible student.
- The eligible student is either yourself, your spouse or a dependent for whom you claim an exemption on your tax return.

*Note that both the American Opportunity Tax Credit and the Lifetime Learning Credit are based upon calendar year, not academic year. This should make it possible to bunch or bundle expenses to maximize education credits.*

**Student Loan Interest Deduction** – For borrowers that take loans to pay school expenses, the IRS allows for a deduction for interest paid on education loans of up to \$2,500. The student must be attending school at least on a half-time basis in a program that must lead to a degree, a certification or nationally recognized credential. Educational programs that do not lead to a degree or other educational credential are not eligible for this deduction. Income phase-outs for this deduction occur as \$60,000 to \$75,000 single filer (\$120,000 to \$150,000 for married filing jointly).

For more information, please see the Instructions for Form 8863 and Form 8863 itself, available through the IRS website and cited in the appendix to this document.

## Real Estate Transactions

*Sales* – With price volatility common in the real estate market, many people are looking for methods to offer properties for sale in ways that make it easy for a buyer to purchase their home. One such method is the installment sale, where the buyer pays part of the purchase price upfront and the remainder over a certain number of years. Since capital gains rates are expected to rise after 2010, it may be beneficial to consider recognizing the capital gain in 2010 when rates are lower. This is one of those rare planning circumstances when it may be better to pay taxes sooner, rather than later because the ultimate amount of tax paid in 2010 will likely be less than in future years. Note that when you are selling depreciable property, the maximum rate on capital gains is 25% to the extent of prior depreciation.

*Purchases* – The First Time Homebuyer Credit has been extended to April 30, 2010 (for contract), June 30 for settlement. The maximum amount of this credit is \$8,000. This credit is phased out for \$125,000 (\$225,000 for married filing jointly) - \$145,000 (\$225,000 FJ). Note that dependents are not eligible to claim the credit, no credit is available on homes over \$800,000 in purchase price and purchaser must be 18 years of age or older.

- If taxpayers claimed a Code 36 first time home for home purchased after April 8, 2008 and before January 1, 2009, that credit needs to be recaptured in equal installments over a 15-year period. If the home is sold or ceases to be the taxpayer(s) principal residence, that recapture is accelerated.

## Other Timely Family Planning Related Credits and/or Deductions:

- For 2009, the maximum Adoption Credit increased to \$12,150, including the employer's adoption assistance program amount. These credits are phased out between \$182,180 and \$222,180. The amount of taxable investment income a child can have without it being taxed at their parent's income tax rate increased in 2009 to \$1,900. In 2009, the amount your earned income must exceed to claim additional child tax credit is reduced to \$3,000. This remains at that level for 2010;
- If you purchased a new car or truck in 2009, you may be eligible to deduct state, local and/or excise taxes on 2009 tax return, limited to the first \$49,500 of purchase price of the vehicle. The deduction is phased out between \$125,000 - \$135,000 (\$250,000 - \$260,000 if married filing jointly.) If you are eligible, this deduction can be added to your standard deduction or through itemization;
- For 2009, the amount of the student loan interest deduction is phased out for Adjusted Gross Incomes between \$120,000 and \$150,000 (married filing jointly). For other filing status', the phase-out occurs between \$60,000 and \$70,000.

## Medical and Health-Related Planning:

- For Health Flexible Spending Arrangement accounts, a new special rule allows for distributions from a health FSA to reservists activated or called to active duty.
- For 2009, the maximum amount of qualified long-term care premiums includible as medical expenses on Schedule A has increased. If you are considering long term care insurance as a way to protect your assets, this may be a wise move and the IRS current guidelines are as follows:
  - » Age 40 and under \$320
  - » Age 41 – 50 \$600
  - » Age 51 – 60 \$1,190
  - » Age 61 – 70 \$3,180
  - » Age 71 and over \$3,980

## Tax Planning Tips for Retirement

### Social Security Adjustments

Because there was no effective increase in the Consumer Price Index from Q3-2008 to Q3-2009 and, therefore, no draining of value of its benefits, Social Security has elected not to increase Monthly Social Security and Supplemental Security Income benefits in 2010. For details about Social Security's history of changing benefits based on cost of living adjustments, visit [www.SocialSecurity.gov](http://www.SocialSecurity.gov).

In 2008 for 2009, the Social Security Administration announced a 5.8% cost of living increase, the largest adjustment in benefit since 1982, and that increase saw the average payment rise by \$63 a month, \$103 per married couple. Maximum monthly Social Security benefits climbed from \$2,185 to \$2,323 and the maximum income subject to Social Security withholding increased from \$102,000 to \$106,800.

### Required Minimum Distributions (RMDs)

The Worker, Retiree and Employer Recovery Act of 2008 was signed into law on December 23, 2008, waiving 2009 Required Minimum Distributions for IRAs, 401(k)s, profit-sharing, Money Purchase Pension, 403(b), and certain 457 retirement plans. The Act does not waive any RMD requirements for 2010.

Generally, retirement account owners who are at least age 70½ must take RMDs by December 31st. Those who withdraw less than the required amount by the deadline may be required to pay the IRS an excise fee of 50% of the shortfall. Ordinarily, the end-of-year value is used to calculate the required amount; however, a taxpayer who has made rollovers during the year may have to recalculate fair market value to reconcile with custodial values, which are usually sent by January 31st.

## **Penalties for Early Withdrawals of IRAs or Qualified Retirement Plans**

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Some taxpayers may be tempted to apply for early withdrawals of funds from retirement plans to alleviate financial hardship. In addition to taxing the withdrawals, the IRS also assesses a 10% penalty on such taxable withdrawals, making this an expensive source of funding. Additionally, if the withdrawal is coming from a SIMPLE plan, and the taxpayer first started contributing to the plan within two years, the early withdrawal penalty is 25%.

There are exceptions to the early withdrawal penalty rules that a taxpayer may wish to consider.

For some early withdrawals from retirement plans, these exceptions may include using the funds for a rollover (either a direct rollover or within 60 days of having received the funds), paying for health insurance premiums if unemployed, paying for education expenses for either the taxpayer or a dependent, paying for medical expenses in excess of 7.5% of AGI, purchasing a home (if the taxpayer did not own a home within two years and limited as to how much of the distribution qualifies to avoid the penalty), is permanently or totally disabled or if the IRS has levied the taxpayer's retirement account to pay off tax debt.

## **Substantially Equal Periodic Payments**

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One important exception to the penalty rules on early withdrawals include "Substantially Equal Periodic Payments" (also referred to as 'SEPP' or '72t', named for the tax code that permits the exception). In order to qualify for the exception, the period must be for a minimum of five years or until the taxpayer is 59½, whichever comes last. There are several methods for calculating permitted withdrawals under 72t, but they are all based upon life expectancy of the taxpayer.

If you are considering a SEPP program, it is important to note that if the program is terminated prior to the deadline period the taxpayer will be required to pay all penalties waived under the program, plus interest, unless the program was terminated due to death or disability of the taxpayer or the depletion of assets due to market losses.

## **Roth IRA Conversions/Rollovers/Recharacterization**

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Beginning January 1, 2010, the \$100,000 Modified Adjusted Gross Income (MAGI) limit on Roth conversions was eliminated, opening up the opportunity for higher income individuals to convert their eligible retirement plan balances to Roth accounts. Eligible plans include all qualified plans, IRAs, SEP IRAs, 403(b) and 457(b) plans. Balances from a SIMPLE IRA can also be converted, but these conversions can only occur after the two-year period beginning on the date when the taxpayer first participated in the SIMPLE IRA account (Code Section 408A(c)(3)).

Also new for 2010, married taxpayers who filed separate returns are now eligible to convert their balances to Roth accounts. Previously, this was not allowed.

Taxpayers should be aware that the actual conversion process is not tax-free. The taxpayer must include in gross income the taxable portion of the conversion amount; but they are not generally subject to penalties for premature distribution. If the taxpayer has made non-deductible contribution to their accounts (IRAs), they would only be required to pay taxes on converting those amounts attributable to the growth on those non-deductible contributions. Another consideration in Roth conversions is that while the 10% premature distribution penalty is waived, that penalty would apply to nonqualified distributions made from the Roth IRA prior to age 59½ and within the five-year period beginning with the first day of the taxable year in which the conversion was contributed and would apply to the portion of the contribution that was includible in income.

For taxpayers who convert to a Roth account after 2010, any part of the distribution that does not represent after-tax contributions will be treated as taxable income for the year.

For 2010 only, taxes owed upon the conversion do not have to be paid in 2010. If the taxpayer prefers, he or she can pay the taxes owed in 2011 and 2012 at the tax rates in those years. The timing of payment of the taxes (in 2010 or half in 2011 and the other half in 2012) is at the discretion of the taxpayer. The taxpayer who expects to be in lower effective tax brackets in 2011 and 2012 has a planning advantage that will likely not exist after 2010. If a taxpayer expects to be in a higher tax bracket in 2011 and 2012, they can elect to pay the tax in 2010. If this election is not made, the IRS will assume that taxes on conversion will not be paid in 2010.

Where the money will come from to pay the taxes is also an important consideration. Ideally, the taxes owed on the conversion should be paid out of investment accounts, not from the proceeds from retirement accounts that are to be converted. For example, a taxpayer in the 25% bracket who has \$40,000 in a traditional IRA could convert the entire balance to a Roth by paying the additional tax with non-IRA money. If, on the other hand, the IRA funds must be used to pay the tax, the taxpayer will have only \$30,000 in the Roth afterwards. And, if the taxpayer is under 59½ and, therefore, has to absorb the 10% penalty tax on the premature IRA distributions (owed even though it is used to pay the income tax on the conversion), the Roth will only have \$29,000 after the conversion.

Because Roth IRAs are funded with after-tax contributions, there is no tax owed upon distributions made from contributions. If the distribution is qualified, earnings also escape taxation. A qualified Roth distribution is tax-free, is made after a five-year period has elapsed, beginning on January 1st of the year for which a taxpayer first made Roth contributions, including any rollover or conversion contributions, and ends on the last day of the fifth year, on or after the taxpayer reaches age 59½, dies, becomes disabled or is buying, building or rebuilding a principal residence.

As a general rule, Roth accounts may be beneficial for taxpayers who have several years before retirement (so there is adequate time to recoup tax money paid upon conversion), who may not need the assets during their lifetime, wish to avoid taking RMDs or those who anticipate being in a higher tax bracket in the future. From a planning perspective, the benefits are reduced for taxpayers who cannot pay the tax on the conversion from non-retirement assets (rather than deplete Roth assets by paying taxes from retirement

assets, which, if the investor is not eligible for a distribution, could result in a penalty).

From a planning perspective, given the difficult market environments in 2008 and early 2009, now may be a particularly attractive time to consider a Roth conversion. Since the Roth conversion is a taxable process based on the value of the assets converted, the taxpayer would benefit from converting securities now that may have less value at the time at which the taxes are assessed than later when they have appreciated.

Converting to a Roth IRA has many advantages, including:

- Tax-free qualified distributions;
- No RMDs;
- No differentiation between assets held in a traditional IRA that will be reduced by distribution taxes and a Roth IRA that will not. Note that both traditional and Roth IRAs are included in your gross estate for estate taxes;
- The ability to re-characterize a Roth conversion (see below for more information);
- The ability to “rate shift” and convert while in a lower tax bracket, thereby saving taxes ;
- Greater flexibility to withdraw without penalty possibly before age 59½.

Re-characterization: A conversion from a traditional IRA to a Roth made in 2010 could be re-characterized or put back into a traditional IRA any time until October 15, 2011, assuming maximum extensions applied to the example. So if you elect to convert in January 2010 and the value of the Roth investments drop any time before October 15, 2011, those assets can be put back into a traditional IRA then, subsequently, a Roth conversion can be elected at the new lower asset values (thereby accomplishing the conversion at a lower tax cost).

Caution must be exercised in re-characterizing, and then later reconverting, as a failure to follow the time guidelines can create a failed conversion as a Premature Re-conversion. The general rules are that a taxpayer must wait until the later of either the beginning of the year following the year in which the conversion occurred or thirty days after the re-characterization is completed.

The Rules for Roth conversions, contributions, maintenance and taxation are controlled by the Internal Revenue Code, §402A. The IRS’s publication 590 on Individual Retirement Arrangements contains an excellent resource on IRAs, both traditional and Roth and can be found on the IRS website at <http://www.irs.gov/publications/p590/index.html>

## Retirement Distributions

**If a taxpayer is considering making distributions from a retirement plan, they may wish to consider several options:**

For the taxpayer who is over 59½:

- If a lower or equal tax bracket is expected for next year, they can try deferring the removal of the assets from the retirement plan until next year.

For the taxpayer who is under 59½:

- Using Substantially Equal Periodic Payments (SEPP) as a technique to minimize penalties;
- Using the distributions for the purpose of paying Qualified Education Expenses or the financing of first home purchase for themselves, their spouse, child, grandchild or other descendant. There may be limitations as to how much may be used, but these would also help to limit the payment of early withdrawal penalties.

## Tax Planning Tips for Securities

### Wash Sale Rules

The Wash Sale Rules were created to prevent a taxpayer from being able to claim a loss while maintaining a substantially uninterrupted ownership of a security. Under the rules, detailed in IRS Publication 550 (available at [www.irs.gov](http://www.irs.gov)), a taxpayer planning to realize capital losses (but not gains) for taxes in the current year will find their losses disallowed if they purchase a “substantially identical security” within a 30-day period either before or after their trade date<sup>1</sup>. If the taxpayer does purchase what constitutes an essentially identical security during that window, the losses become deferred (by adding them to the cost basis of the new stock), but the immediate loss recognition is not permitted. During years of turbulent market returns, the tendency may be to help mitigate losses in a portfolio by claiming the tax loss. If the taxpayer wishes to ultimately maintain ownership in the position, they need to be aware of Wash Sale Rules as a primary step to avoid becoming subject to them.

### Capital Gains and Losses

Assets owned and then sold, or otherwise disposed of, may generate a capital gain or loss. Careful timing of when you sell assets may help you to reduce your federal income tax liability.

As a general rule, if you have realized capital gains or losses over a given year, you can offset one with the other. If you have net capital gains, you may wish to look to which securities have losses that could be harvested to save on capital gains tax. Assets that have been held longer than one year are considered long-term; assets held for less than a year are considered short-term. The distinction is an important one. Further details are as follows, but you should seek tax advice to make sure that the following is relevant to your tax situation:

- The maximum tax rate for long-term capital gains is 15% for both ordinary income tax and for AMT, but long-term capital gains are preference items for calculation of Minimum Tentative Tax. Be aware that, for some investors, specifically those with lower taxable income (this encompasses those who, for 2009, were in the 10% and 15% Federal tax brackets, effectively \$33,950 for a single; \$67,900 for a married couple), tax rates on capital gains would be 0%, so the harvesting of capital losses would be wasted, since they will not be taxed on their gains anyway. For these individuals, it may make sense to harvest gains instead of losses, looking to sell appreciated securities without having to pay capital gains tax on those sales;
- Gains and losses on assets owned less than one year are short-term. In calculating the tax on sales of assets, a taxpayer must

first net the short-term gains and losses, then net the long-term gains and losses independently. Then the short-term and long-term gains/losses are netted against one another. If a net capital loss is generated, it may be used to offset up to \$3,000 of ordinary income (\$1,500 if taxpayer is filing as married-filing separately) and the unused portion, if any, may be carried forward indefinitely until the death of the taxpayer at which point the carry-forward expires. Capital losses realized on the sale of securities may also be used to offset capital gains on other classes of assets, such as real estate and vice versa on Schedule D. Be sure to check to see if you are already carrying losses over into 2010 from previous years;

- Careful planning to harvest any capital gains or losses from sales of stock or other capital assets can help to minimize tax on gains and maximize the tax benefit from losses. Normally, a taxpayer should try to avoid having long-term capital losses offset long-term capital gains, since those losses will be more valuable if they are used to offset short-term capital gains or ordinary income. To do this requires making sure that the long-term capital losses are not taken in the same year as the long-term capital gains;
- After 2010, capital gains rates may climb to 20% and 10% (18% and 8% with eligible holding period over five years) and tax planning in 2010 may include a capital gains component in which you elect which gains to pay in the current year instead of waiting until rates have gone higher;
- Planning for the offsetting of gains and losses is not just a tax issue. As is the case with most planning involving capital gains and losses, investment factors need to be considered. The decision to wait to defer a gain until the next year needs to be balanced against the risk to the value of the property, whether its value may decline before it can be sold. Similarly, a taxpayer should not risk increasing the loss on property that he expects will continue to decline in value by deferring the sale of that property until the following year;
- A taxpayer is permitted to identify which shares are sold during a given year as part of their transaction. These are called “versus purchase” sales and allow taxpayers to identify which shares are sold to best advantage from a capital gains/loss standpoint;
- A taxpayer who owns appreciated mutual funds, which may also be good candidates for sale, may wish to consider selling those funds prior to the December capital gains payment made by fund managers to shareholders. A 15% capital gains rate is much better than having to pay ordinary income tax rates, which could be as high as 35%. There are also other advanced planning techniques that can be used to help defer the payment of capital gains tax.

## **Planning with Qualified Dividend Income**

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According to the Jobs and Growth Tax Reconciliation Act of 2003, and later upheld by the Tax Increase Prevention and Reconciliation Act of 2005, qualified dividend income received in 2010 will most likely be taxed at the same favorable tax rates that apply to net capital gains. However, barring further tax legislation, beginning in 2011, qualified dividends are expected to be

taxed at the generally more expensive ordinary income tax rates.

Dividend income is considered “qualified” if received from domestic corporations or certain (qualified) foreign corporations. Additionally, for the dividend income to be qualified, the stock must have been held by the taxpayer for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (for certain preferred stock, more than 90 days during the 181-day period beginning 90 days before the ex-dividend date).

The tax-reduction strategy of shifting out of interest-paying investments and into dividend-paying stocks must be undertaken with enough time left in the year to satisfy the holding-period requirements noted above. Although qualifying dividend income is taxed at the same rates as net capital gain, it is not treated as capital gain for purposes of netting capital losses against capital gains.

Tax rates on qualified dividends and net capital gains have been historically 5% for taxpayers paying tax rates up to 25% and 15% for taxpayers paying tax rates above 25%. For 2009 and 2010, the 5% maximum tax rate on qualified dividends and net capital gain (excess net long-term capital gain over net short-term capital loss) has been reduced to 0%. The 15% maximum tax rate has not changed.

## **Tax Planning Tips for Estates, Wealth Transfer & Gifting**

### **Estates**

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As of the current writing of this document, it is still not clear the direction that Congress will decide upon estate planning applicable exclusion amounts, GST (generation skipping transfer) and tax rates for 2010. Without a definitive decision, there would be no estate tax for 2010 and, in 2011, rates are scheduled to be reset to 2001 levels. This is unlikely, however, and it is possible that Congress will pass retroactive legislation in 2010 that will impact any estates that hit in 2010, whether before or after the legislative date. As such, the tax planning tips given will be based upon tax rates and assumptions that were current for 2009, unless otherwise noted.

Also, due to uncertainty of future exclusions for estate plans, a number of states have “de-coupled” from the Federal exclusion amounts. In effect, this is an attempt by the states to counter the rapid decline in estate tax revenue, based on decisions made at the Federal level. The act of de-coupling from the Federal guidelines means that more taxpayers will owe state inheritance taxes than Federal estate taxes, and planning for those state death taxes may become a higher priority for you than for the Federal tax.

One of the few advantages of turbulent market years is that they provide some relief in easing the transfer of wealth to younger generations. Whether giving wealth away to trusts, charities or other people, depressed value can help to minimize taxes and other administrative problems associated with building an estate plan. This can be interpreted as saying that one way of cutting transfer taxes is to transfer less in assets, but if values are depressed, they may well recover once out of the estate under new ownership by that younger generation.

## Wealth Transfer & Gifting

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During periods of difficult markets, it may seem superfluous to speak of giving wealth away, whether planning for beneficiaries, charities or other potential recipients. But this is one of the areas in which difficult markets can help in the process of transfer to a greater effect than in more bullish times.

Last, gifting can be one of the most effective methods, if employed within guidelines to efficiently transfer wealth.

### Gifting

- Although an individual can give \$13,000 per person per year (a married couple can provide separate gifts of \$13,000 each for a maximum total of \$26,000 in 2010) to an unlimited number of individuals without incurring gift taxes or using his or her \$1,000,000 lifetime gift exclusion but unused exclusions cannot be carried over from one year to the next. This is unchanged from 2009 for the same reason that Social Security did not increase their benefits: the Consumer Price Index (generally regarded as a standard index for inflation) did not record a need for a cost of living adjustment.
- Gifts of securities held in street name by Janney on your behalf are not considered completed until the position is credited to the donee's account. If the security is held in registered form in the name of the owner, the gift is not completed until the registered owner has formally changed on the corporate books.
- Gifts of cash are not considered to have been completed until the check is paid by the bank on which it is drawn, not when the check is given to the donee. A client can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year.

## Charitable Contributions

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The timing of charitable contributions can have an important impact on year-end tax planning. Charitable contributions should be timed so as to obtain the maximum tax benefits for the year. If a taxpayer plans to make a charitable contribution in 2011, he or she should consider making it this year instead if speeding up the deduction would produce an overall tax savings (i.e., because the taxpayer will be in a higher marginal tax bracket in 2010 than in 2011).

- On the other hand, a taxpayer who expects to be in a higher bracket in 2011 may wish to consider deferring their contributions;
- In making any sizeable charitable contributions, the contributions should be made, to whatever extent is possible, in appreciated capital gain property that would result in a long-term capital gain, if sold. That way, a deduction generally is obtained for the full value of the property, such as shares of stock, etc., while any regular income tax on the appreciation in value is avoided. One caveat to this deduction is that for tangible property this favorable treatment is only available if the donated item is related to the exempt purpose of the donee charity;

- An additional consideration is that gifts made with short-term capital assets are limited only to a deduction equal to the purchase price of the asset.

## Tax Planning Tips for Businesses

In today's economy, finding ways to minimize the tax burden upon your business is even more necessary than ever. To that end, here are some current planning tips that you may find helpful:

- 2010 will see Section 179 expensing elections returning to more historic levels. Section 179 expenses allow for the deduction (rather than the depreciation) of business items such as new equipment, furniture, computer software, etc. The eligible items are those that are tangible, limited and depreciable property acquired for the use in conduct of a trade or a business. Note that this election can only be used to offset net income, not reduce it below zero. This election is primarily for small businesses. If a business places more than \$530,000 in property qualifying for Section 179 into place, the benefits are phased out. For 2008 and 2009, the Section 179 expense was raised to \$250,000. In 2010, the Section 179 expense will return to the 2007 level of \$125,000. Furthermore, the phase-out has been reduced from \$800,000 in 2009 to \$530,000 in 2010;
- If you recently purchased or built a building or are remodeling an existing space, consider a cost segregation study to identify property and costs that can be depreciated over five or seven years using 200% of the straight line method or over 15 years using 150% of the straight line method. Typical assets would include security equipment, decorative fixtures, parking lots, landscaping and architectural fees;

For businesses in particular, the tax-planning advantages of accelerating deductions and forestalling income becomes even clearer. In the case of business losses, if a client owns an interest in a partnership or S-corporation, he or she may need to determine if their basis in the entity (or amount at risk for passive investments) would allow the deduction of an operating loss for this year.

One of the most effective tax planning techniques for the business owner involves retirement plans, whether establishing a new plan or contributing to an existing one. To obtain the credit, the business owner would need to file Form 8881, Credit for Small Employer Pension Plan Startup Costs. This document is linked in the appendix.

- If you have a small business with employees and you have not sponsored a plan for three prior years, the IRS allows a three year \$500 tax credit for startup costs, which is much better than a deduction as a tax credit, and is a dollar-for-dollar reduction in taxes, not taxable income. The credit is an offset used to help cover administrative expenses;
- If your business already has a retirement plan set up, then making a contribution on behalf of your employees can also be a good way to offset income. If you are a sole proprietor, you can set up a SEP (Simplified Employee Pension) plan and contribute up to \$49,000 for yourself, depending on the level of your compensation. You may also have to make contributions for other eligible employees. Although a SEP plan

can be set up as late as when you file your return for 2009, if your tax advisor suggests that a Solo 401(k) would be better for your situation (which is possible, as it allows for contributions of up to \$54,500 for a business owner over 50), you must establish it by December 31. Note that a Solo 401(k) is only available when there are no other employees.

For taxpayers using the cash-basis accounting method, deferrals of issuing bills-due and invoices-due to customers until the following year, if such deferral is reasonable and practical, may prove to be helpful. For example, every cent deferred for collection into January 2011 will not be taxed until (potentially) April 2012. Be aware, though, that if a customer offers to pay in the current year, it must be accepted. Any deferral strategy may be dependent upon your business structure and you should speak to your tax advisor to be sure that the strategy makes sense for your business.

Make equipment purchases in the current year. Be sure to check current deduction allowances on the IRS website, but note that annual Section 179 provisions can generally allow you to immediately deduct up to \$128,000 so long as it is up and running by year-end and is limited by your business' taxable income.

Prepay any reasonable expenses, including cash bonuses, if you can afford them, office supplies, utility bills, professional subscriptions, travel and equipment repairs and upgrades.

Lastly, although charitable contributions can be a great way to offset business income, the business owner should be aware that sole proprietors and S-corp owners cannot take charitable donation deductions. Such donations would be passed to their owner as an itemized deduction on their individual returns.

## Tax Planning Tips for Personal Expenditures and Other Items

### Personal Expenditures

- Consider using a credit card to prepay any expenses that may generate deductions for this year;
- If you are thinking of making energy-saving improvements to your home, such as putting in extra insulation or installing energy saving windows, consider doing so before year-end in order to qualify for a tax credit that may be available;
- If you are thinking of buying a hybrid vehicle that would be eligible for a tax credit, purchase it before year-end;
- 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 this year's casualty loss deduction.
- You may be able to save taxes this year and next year by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions;
- Those facing a penalty for underpayment of estimated taxes may be able to eliminate or reduce it by increasing their withholding;
- This year, the Kiddie Tax rules have changed. A Kiddie Tax is charged at the parents' tax rate on any unearned income in excess of \$1900, up from \$1800 in 2008. This year, it could

become a problem for individuals up to 24-years old if they are full-time students. If the child is 18-23 and has earned income of more than half their total support, 18-23 and not a full-time student or if the child is married and filing a joint return, they are not subject to the Kiddie Tax rules.;

- Consider extending subscriptions to professional journals, paying union or professional dues, enrolling in (and paying tuition for) job-related courses, etc., to bunch into 2010 miscellaneous itemized deductions subject to the 2%-of-AGI floor.

## Other Tax Planning Tips

### Optimizing Employee Benefits

Increase the amount set aside for next year in an employer's health flexible spending account if the amount set aside was too little for this year. Some of these plans allow employees to carry over unused amounts from year to year, and upon retirement, could be used to pay for retiree medical or long term care insurance premiums. Don't forget that these plans may also allow tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.

### Deferral of Bonus Payments

It may be advantageous to try to arrange with your employer to defer receiving a 2010 year-end bonus until 2011.

### Deduction of Sales Tax

Congress has elected to extend the deduction for state and local sales and use taxes. If a taxpayer's sales taxes add up to more than their state income taxes, then the taxpayer can, if they are itemizing, take a deduction for those sales taxes. For tax years beginning before 2009, taxpayers may elect to take state and local general sales and use taxes as itemized deductions instead of deducting state and/or local income taxes. This is particularly useful in states in which there is no state tax but there is a state sales tax (Florida, Nevada, South Dakota, Texas, Washington, Wyoming and Tennessee), in which case it acts as an additional income-tax deduction. Taxpayers who make this election may either (a) deduct their actual sales and use taxes or (b) use IRS-published tables and then add to the amount from those tables the actual amount of their sales tax for certain "big-ticket" items: motor vehicles, boats, aircraft, homes (including mobile and pre-fabricated homes) and home building materials. The IRS has published tables based on the average consumption by taxpayers, on a state-by-state basis, of items other than motor vehicles, boats, etc., taking into account total available income, number of exemptions claimed and the rate of state general sales taxation. A big-ticket purchase before the year-end can make the election to deduct state and local general sales and use taxes worthwhile. The IRS offers tax tables with standard sales tax deduction amounts as well as an online Sales Tax Deduction Calculator at [www.irs.gov](http://www.irs.gov) and <http://apps.irs.gov/app/stdc>.

# Appendices

## 2010 Annual Limits Relating to Financial Planning

### QUALIFIED PLANS

Elective deferrals 401(k), 403(b), 457, and SARSEPs ...	\$16,500
Catch-up contribution .....	\$5,500
Defined contribution (§415) .....	\$49,000
Defined benefit (§415) .....	\$195,000
SIMPLE plan .....	\$11,500
SIMPLE catch-up contribution .....	\$2,500
Maximum includible compensation .....	\$245,000
Highly compensated employee .....	\$110,000
Key employee (top-heavy plan) .....	> \$160,000
SEP participation limit .....	\$550
IRA or Roth IRA contribution limit .....	\$5,000
IRA or Roth IRA catch-up.....	\$1,000
IRA deduction phaseout for active participants	
Single .....	\$56-\$66,000
Married filing jointly <sup>1</sup> .....	\$89-\$109,000
Married filing separately .....	\$0-\$10,000
Roth IRA phaseout	
Single .....	\$105-\$120,000
Married filing jointly .....	\$167-\$177,000

### SOCIAL SECURITY

SS taxable wage base .....	\$106,800
SS tax rate-employee <sup>2</sup> .....	7.65%
SS tax rate-self-employed .....	15.30%
Earnings limitation:	
Below NRA (\$1 for \$2) .....	\$14,160
Persons reaching NRA (\$1 for \$3) .....	\$37,680
(Applies only to earnings for months prior to attaining NRA)	
Social Security cost-of-living adjustment .....	0%
Quarter of coverage .....	\$1,120
Maximum benefit: worker retiring at NRA <sup>3</sup> .....	\$2,323

### ESTATE AND GIFT TAX

Annual gift tax exclusion .....	\$13,000
Estate tax exclusion .....	\$3,500,000*
Gift tax exclusion .....	\$1,000,000
Generation skipping .....	\$3,500,000*

\* 2009 Levels shown. Congress has yet to determine 2010 exclusions for Federal Estate and Generation Skipping taxes

### HEALTH SAVINGS ACCOUNT

Minimum Deductible amount	
Single .....	\$1,200
Family .....	\$2,400
Maximum Out-of-Pocket Amount	
Single .....	\$5,950
Family .....	\$11,900
HSA Statutory Contribution Maximum	
Single .....	\$3,050
Family .....	\$6,150
Catch-Up Contribution (age 55 older) .....	\$1,000

### EDUCATION

EE bonds for education-phaseout of exclusion	
Single .....	\$ 70,100 - \$85,100
Married Filing Jointly .....	\$105,100 - \$135,100
Coverdell Education Savings Account phaseout	
Single .....	\$ 95,000 - \$110,000
Married Filing Jointly .....	\$190,000 - \$220,000
American Opportunity Credit	
(Up to \$2,500 per eligible student, part may be refundable)	
Single .....	\$ 80,000-\$ 90,000
Married Filing Jointly .....	\$160,000 - \$180,000
Lifetime Learning Credits (Up to \$2,000 per eligible student)	
Single .....	\$ 50,000 - \$ 60,000
Married Filing Jointly .....	\$100,000 - \$120,000
Education loan deduction phaseout	
Single .....	\$ 60,000 - \$ 75,000
Married Filing Jointly .....	\$120,000 - \$150,000

### INCOME TAX EXEMPTIONS AND DEDUCTIONS

Personal exemption .....	\$3,650
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There is NO phaseout of personal exemption for 2010

Standard deduction

Single .....	\$5,700
Joint .....	\$11,400
Head of household .....	\$8,400
Married-filing separately .....	\$5,700
Kiddie tax standard deduction .....	\$950

Elderly or blind additional deduction

Single .....	\$1,400
Married .....	\$1,100

There is NO phaseout of itemized deductions for 2010

Section 179

Maximum election .....	\$134,000
Phaseout begins .....	\$530,000

Adoption credit

Maximum .....	\$12,170
Phaseout .....	\$182,500-\$222,520

### STANDARD MILEAGE RATES

Business use .....	\$0.50 per mile
Charitable use .....	\$0.14 per mile
Medical or moving use .....	\$0.165 per mile

*This material is being provided for informational purposes only, and should not be construed or interpreted as tax advice. You should seek the assistance of a professional tax advisor to discuss how these figures could affect your individual situation.*

<sup>1</sup> For Married Couples who file a joint return and only one spouse is an active participant, the AGI phaseout is \$166,000-176,000.

<sup>2</sup> The Social Security tax Rate is comprised of two separate payroll taxes: 6.2% for Old-Age, Survivors, and Disability Insurance (OASDI) and 1.45% for Hospital Insurance (HI).

<sup>3</sup> For Retirees born in 1940, NRA is 65 and 6 months; for retirees born in 1941, it is 65 and 8 months.

## 2010 Tax Brackets and Standard Deductions

Married Filing Jointly				
Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0.00	\$16,750.00	\$0.00	10%	\$0.00
\$16,750.00	\$68,000.00	\$1,675.00	15%	\$16,750.00
\$68,000.00	\$137,300.00	\$9,362.50	25%	\$68,000.00
\$137,300.00	\$209,250.00	\$26,687.50	28%	\$137,300.00
\$209,250.00	\$373,650.00	\$46,833.50	33%	\$209,250.00
\$373,650.00		\$101,085.50	35%	\$373,650.00

Single				
Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0.00	\$8,375.00	\$0.00	10%	\$0.00
\$8,375.00	\$34,000.00	\$837.00	15%	\$8,375.00
\$34,000.00	\$82,400.00	\$4,680.25	25%	\$34,000.00
\$82,400.00	\$171,850.00	\$16,781.25	28%	\$82,400.00
\$171,850.00	\$373,650.00	\$41,827.25	33%	\$171,850.00
\$373,650.00		\$108,421.25	35%	\$373,650.00

Head of Household				
Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0.00	\$11,950.00	\$0.00	10%	\$0.00
\$11,950.00	\$45,550.00	\$1,195.00	15%	\$11,950.00
\$45,550.00	\$117,650.00	\$6,235.00	25%	\$45,550.00
\$117,650.00	\$190,550.00	\$24,260.00	28%	\$117,650.00
\$190,550.00	\$373,650.00	\$44,672.00	33%	\$190,550.00
\$373,650.00		\$105,095.50	35%	\$373,650.00

Married Filing Separately				
Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0.00	\$8,375.00	\$0.00	10%	\$0.00
\$8,375.00	\$34,000.00	\$837.50	15%	\$8,375.00
\$34,000.00	\$68,650.00	\$4,681.25	25%	\$34,000.00
\$68,650.00	\$104,625.00	\$13,343.75	28%	\$68,650.00
\$104,625.00	\$186,825.00	\$23,416.75	33%	\$104,625.00
\$186,825.00		\$50,542.75	35%	\$186,825.00

Estates and Trusts				
Taxable income is over	But not over	The tax is	Plus	Of the amount over
\$0.00	\$2,300.00	\$0.00	15%	\$0.00
\$2,300.00	\$5,350.00	\$345.00	25%	\$2,300.00
\$5,350.00	\$8,200.00	\$1,107.50	28%	\$5,350.00
\$8,200.00	\$11,200.00	\$1,905.50	33%	\$8,200.00
\$11,200.00		\$2,895.50	35%	\$11,200.00

Deductions/Exemptions	
Standard Deductions	Amount
Married Filing Jointly	\$11,400
Single/Married Filing Separately	\$5,700
Head of Household	\$8,400
Personal Exemptions	\$3,650
Kiddie Tax Exemption	\$950

*This material is being provided for informational purposes only, and should not be construed or interpreted as tax advice. You should seek the assistance of a professional tax advisor to discuss how these figures could affect your individual situation*

**\*\* For an individual who can be claimed as a dependent on another's return, the basic standard deduction in 2008 is limited to the greater of (a) \$900 or (b) \$300 plus the individual's earned income, but not more than the basic standard deduction.**

**\*\* The additional standard deduction for married and surviving spouse taxpayers 65 or older, or blind will be \$ 1,100 each.**

**\*\* For a single taxpayer or head of household who is 65 or older, or blind, the additional standard deduction is \$ 1,400.**

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## Helpful Links

### IRS Links

- *Form 8881* – Credit for Small Employer Pension Plan Startup Costs.” Internal Revenue Service. IRS.GOV, Dec. 2006. Web. 25 Jan. 2010. <<http://www.irs.gov/pub/irs-pdf/f8881.pdf>>.
- *Index* – A listing of IRS Publications, sorted by publication number, with topics titles and links to access a wide range of tax planning documents. <http://www.irs.gov/publications/index.html>
- *Internal Revenue Service*. Internal Revenue Code : § 1091. IRC-Income Taxes-Normal Taxes- “Loss from Wash Sales of Stock or Securities.” *\_Internal Revenue Code*. [http://www.taxalmanac.org/index.php/Internal\\_Revenue\\_Code:Sec.\\_1091.\\_](http://www.taxalmanac.org/index.php/Internal_Revenue_Code:Sec._1091._)
- *Publication 509* – Tax Calendars for use in 2010. This is an excellent reference for all tax related calendar dates for individuals, business owners and/or employers. This also includes a list of Tax Publications for Business Taxpayers <http://www.irs.gov/pub/irs-pdf/p509.pdf>
- *Publication 590* – Individual Retirement Arrangements, an excellent IRS published resource discussing Traditional and Roth IRAs <http://www.irs.gov/publications/p590/index.html>
- *Publication 950* – Introduction to Estate and Gift Taxes, this is an invaluable resource for people seeking information about the estate and gift tax laws. Please keep in mind that, although it was updated in December 2009, it may not contain

up to the minute information with regard to current tax regulations. It does, however, contain a great deal of information about the relevant areas of tax law that may impact your estate or an estate with which you may be affiliated. <http://www.irs.gov/pub/irs-pdf/p950.pdf>

- *Publication 559 – Survivors, Executors and Administrators*, similarly for Publication 950, the IRS also published Publication 559 to further point out details of estate plan from the other perspective, that of survivors, executors and beneficiaries. <http://www.irs.gov/pub/irs-pdf/p559.pdf>
- *Tax Information for Business' and Business Owners*: A reference for all business owners, the IRS website contains a number white papers on a variety of useful subjects, some of which were mentioned in this tax planning guide. <http://www.irs.gov/businesses/>

#### **Please note**

Janney Montgomery Scott is not a tax advisor. While we may help to provide direction which you may wish to consider when making decisions that have an effect upon your tax picture, we suggest that you consult with whoever you depend on for tax advice or research as to whether any tax-related suggestions may be relevant to your situation.

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