1960 Pacific Coast Hwy., Lomita, CA 90717

2010 Year-end Tax Planning - General

Dear Client:
This year has brought many federal tax changes that impact taxpayers of all types. New or extended tax incentives, especially for businesses, can help maximize an individual's or business' tax savings at year-end. This letter highlights some of the year-end planning opportunities and challenges for individuals and businesses.

Individuals

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and subsequent legislation reduced the individual income tax rates to their current (2010) brackets of 10, 15, 25, 28, 33, and 35 percent. The reduced rates are scheduled to expire after December 31, 2010 to be replaced by rates of 15, 28, 31, 36, and 39.6 percent. Bills have been introduced in Congress to extend some or all of the reduced rates either for two years or to make the rate reductions permanent.

Congress may take up the fate of the reduced rates during an expected lame duck session after the November elections. Our office will keep you posted of developments. In the meantime, individuals should consider accelerating income, if possible, into 2010, to take advantage of the certainty of the reduced rates for 2010. Employers may want to accelerate bonuses to employees. Other year-end planning considerations include contributing to a retirement savings account and converting a traditional IRA to a Roth IRA.

A closely related planning consideration involves capital gains and dividends. Reduced capital gains and dividend tax rates are scheduled to expire after December 31, 2010, although, as with the regular income tax rates, Congress is expected to extend some, if not all, of them. Individuals with investment gains may want to consider taking them in 2010 to lock-in at the reduced tax rates. To allow shareholders to take advantage of the current lower tax rates before they expire, corporations may plan to accelerate the distribution of dividends.

Many individuals also must prepare for the expiration of the Making Work Pay Credit (MWPC). The MPWC has been under most taxpayers' radar because its benefit is seen in wage earners' paychecks. Individuals who receive a paycheck and are subject to withholding, the credit is handled by their employers through automated withholding changes in place since early 2009. These changes often resulted in an increase in the amount of take-home pay in 2009 and 2010. Once the MWPC expires, individuals who saw an increase in take-home pay may experience a reduction in take-home pay from those amounts.

Since the start of 2010, many individuals have been questioning whether the so-called "tax extenders" will be extended. These are popular but temporary tax incentives, many of which expired at the end of 2009. Some of the most popular are the state and local sales tax deduction, the higher education tuition deduction and the teachers' classroom expense deduction. Congress could vote to extend these incentives through the end of 2010 during the lame duck session. Our office will keep you posted of developments.

Many individuals are also waiting for Congress to enact an AMT patch for 2010. In recent years, Congress has "patched" the AMT to prevent it from encroaching on middle income taxpayers. The patch has traditionally provided higher AMT exemption amounts and other relief. It is unclear if Congress will take up an AMT patch during the lame duck session. The patch is expensive because of the lost tax revenues.

The fate of the federal estate tax is also complicating year-end planning for individuals. The federal estate tax is scheduled to revert to pre-EGTRRA rates for decedents dying after December 31, 2010 and the applicable exclusion amount will be $1 million. Under current law, the federal estate tax is abolished for 2010, replaced by a carried over basis at death regime. While some compromise extension of the estate tax is expected, the final details are far from settled at this point.

Additional year-end considerations for individuals include:

1. Home energy efficiency projects, such as energy efficient windows and doors that may be eligible for energy tax credits;
2. Impact of health care reform, such as new restrictions on the use of funds in health flexible spending arrangements (FSAs), new rules keeping children under age 26 on their parent's family policy, no lifetime limits on coverage, and more;
3. Navigating the variety of education tax incentives, including the expected expiration of the American Opportunity Tax Credit after 2010;
4. Casualty losses from qualifying events;
5. Tax incentives for job-search expenses; and
6. Expiration of COBRA premium assistance.

Businesses

Businesses, like individuals, are confronted with uncertainty in tax planning. However, recent passage of the Small Business Jobs Act of 2010 has provided some certainty. The new law extended two valuable tax incentives for businesses: 50 percent bonus depreciation and increased Code Sec. 179 expensing.

Additionally, 50-percent bonus depreciation is extended for qualified property placed in service before January 1, 2011. The Small Business Jobs Act also allows taxpayers to claim additional depreciation for the purchase of automobiles and light trucks through the end of 2010.

Code Sec. 179 expensing allows taxpayers to elect t o recover all or part of the cost of qualified property, up to a limit, by deducting it in the year it is placed in service. The Small Business Jobs Act of 2010 increased the Code Sec. 179 expensing dollar and phase-out investment limits to $500,000 and $2 million respectively for tax years beginning in 2010 and 2011. The Small Business Jobs Act also allows taxpayers to elect up to $250,000 of the $500,000 Code Sec. 179 deduction limit (subject to the investment limitation) for qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property. Taking bonus depreciation or Code Sec. 179 expensing, however, is not always the best choice, depending upon a business's tax history. If a business has net operating loss (NOL) carryforwards from prior lean years, especially if they are about to expire, minimizing deductions and increasing the recognition of income currently to absorb those NOLs could be worthwhile year-end planning consideration.

Businesses that hire new employees after February 3, 2010 and before January 1, 2011 may qualify for a special payroll tax exemption. The exemption effectively negates the employer's share of Social Security taxes paid on qualified new hires after March 18, 2010 and before January 1, 2011. Businesses also may qualify for a worker retention tax credit.

Health care costs are always of concern to employers, especially to small businesses. For 2010, small businesses may qualify for a new tax credit. The maximum credit is 35 percent for for-profit employers and 25 percent for non-profit employers. The maximum credit goes to employers with 10 or fewer full-time equivalent employees paying average annual wages of $25,000 or less. The credit is completely phased–out for employers with more than 25 FTEs or with average annual wages of more than $50,000.

Additional year-end considerations for businesses include:

1. Uncertainty over the fate of expired business tax extenders, such as the research tax credit, brownfields remediation incentives, incentives for film and television production, and more;
2. Code Sec. 199 domestic production activities deduction, potentially valuable but often under-utilized;
3. Work Opportunity Tax Credit; and
4. Energy tax incentives.

If you have any questions about the year-end planning opportunities and challenges we have highlighted, please contact our office. Tax legislation before 2011 could also impact year-end planning. Our office will keep you posted of developments.

Sincerely yours,

Husam AbuSneineh
Accountant
STS Financial
310-5349829