Tax Planning Letter

Annual 2009

Dear Clients and Friends,

As we approach the end of 2009, it seems evident that taxes will soon go higher. In the past decade tax legislation has provided lower tax rates and many targeted tax deductions and credits. Most of these provisions will expire at the end of 2010. That fact and the current search for revenue to fund health care reform will lead inevitably to higher taxes. The only questions are when, at what income levels, and by how much?

Though Congress is focused on health care legislation, there are other important tax priorities. One is the alternative minimum tax, which if left unchanged, will affect more than 27 million taxpayers next year. Another is the estate tax, scheduled to expire in 2010 only to return again in 2011 at previous levels.

This *Letter* is being sent to remind you that right now is the ideal time to identify actions you can take before year-end to cut your 2009 taxes. It's also the right time to review your overall tax strategy in light of the coming tax changes. Please call if you have questions or if you would like to get together to discuss your tax-cutting options.

The Griffith CPA Firm, PLLC

6812 Crumpler Blvd. Suite 100 Olive Branch, MS 38654 | 662-893-TAXX | www.griffithfirm.com

New rules provide tax savings now, benefits later

Whether you think the economy is on the road to recovery or stuck in neutral, one thing is clear: cutting taxes has never been more important. Fortunately, there are special incentives this year to both save taxes and help jump start the economy. Find out why the final months of 2009 may be your best opportunity in years to trim your tax bill and invest for the future.

Look on the home front

It's not too late to lower your 2009 taxes through energy-efficient home upgrades. Installing qualified windows and skylights can provide a tax credit, as can installing exterior doors, roofing, and insulation that meet energy-saving standards. What's more, a tax credit is available for up to 30% of the cost of major energy-savers, such as a qualified solar water heater or geothermal heat pump.

Need a new car? The *American Recovery and Reinvestment Act of 2009* provides a deduction for sales taxes paid on new cars, light trucks, motorcycles, and even motor homes. The deduction is limited to the tax on $49,500 of the purchase price. You don't have to itemize to take the deduction, and if you live in a state without sales tax, you can still deduct other fees and taxes associated with the sale.

Invest in your business

The *Recovery Act* restored the higher Section 179 equipment expensing limit, allowing small businesses to write off as much as $250,000 of new or used equipment purchased this year. In addition, brand new equipment, software, and leasehold improvements can qualify for a 50% first-year bonus depreciation deduction if purchased and placed in service before the end of 2009.

The *Recovery Act* also helps businesses invest in their most important asset – their employees. Employers can provide employees with a tax-free fringe benefit of up to $230 per month for qualified mass transit and van pooling expenses.

Invest in yourself

Having thoughts about returning to school? Now may be the time. Up to $4,000 of higher education costs for yourself, your spouse, or a dependent can be deducted from taxable income in 2009 if you meet the income limits ($65,000 or less for singles, $130,000 or less for joint filers). If income exceeds these amounts, the deduction drops to a $2,000 limit. Above income of $80,000 for singles and $160,000 for couples, no deduction is allowed.

There's also a revamped Hope Credit for educational expenses. The credit is now named the American Opportunity Tax Credit, and it's been increased to $2,500 a year. What's more, the credit applies to four years of college, not just the first two, and 40% of the credit is refundable. Income limits apply here too.

Help your favorite charity

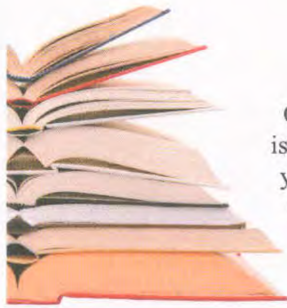
Recent economic times have probably been hard on your favorite charity, and there are ways for you to help. Last year, Congress extended through 2009 the charitable IRA rollover provision which allows those aged 70½ or older to make tax-fi distributions of up to $100,000 direct from an IRA to a qualifi charity. Businesses can help charities as well by taking advantage of the newly enhanced deductions for donations of qualifi food, books, and computer equipment.

This is also a good time to look through yoı closets and donate unneeded clothing and oth household items to charity. Just be sure to keep your receipts. Recent tax law changes have ratcheted up the recordkeeping required for both cash and noncash charitable deductions.

If you use your vehicle for charitable activ ities, take note of a recent IRS clarification o what you can deduct. You can deduct either a standard rate of 14¢ a mile, or with reliable written records, yc can deduct actual out-of-pocket expenses for your vehicle usag in charitable volunteer work.

Hit the books

Some tax-cutting options remain the same from year to yeaı Proper recordkeeping is always a winning strategy. Are you keeping track of your business mileage? Is your accounting for home office deductions up to date?



One standard tax planning rule is to defer income to the next year and accelerate deductions into the current year. Cash basis business owners might hold off billing some of their December work until January. Consider stocking up on supplies and paying invoices early. Individuals may want to prepay their real estate taxes, especially now that nonitemizers can also deduct real estate taxes (limited to $500 for singles and $1,000 for joint filers). If you have significant medical expenses, try to consolidate the payment of medical bills into one calendar year to exceed the 7.5% of income threshold.

The general expectation is that tax rates will go higher next year. If you think that will happen, you may want to reverse this strategy and pull income into 2009 and delay deductions until 2010. It's always wise to take a multi-year approach to tax planning.

Another smart move is to check your tax withholding and estimated tax payments. Assumptions you made going into this year may have been dramatically affected by the economy. Also, the "making work pay" credit may have reduced the amount of tax withheld from your paycheck. Those who may end up with too little withheld as a result of this credit include married couples with two incomes, individuals with more than one job, retirees, and social security recipients who also work. Remember, if you pay in too much, you tie up important cash. Pay too little, and you could end up owing a penalty.

If the majority of your income is from a small business, there is an added reason to check your withholding or estimates in 2009. You may be permitted to pay in the lower of 90% of your 2008 or 2009 tax bill and still avoid penalties.

Have a plan

Through economic recessions or expansions, tax planning is one strategy that always makes bottom-line sense. Not every strategy mentioned here is appropriate for everyone, and other options not discussed may be more suitable in your particular situation. For help in identifying and utilizing the tax breaks that fit your circumstances, contact us now. ❑

YOUR INVESTMENTS

Tax rules offer upside to stock market decline

Has last year's stock market decline still got you down? While it may have given you plenty of headaches, the losses may have a tax upside. Consider the following strategies between now and the end of the year to restructure your portfolio in a tax-efficient manner.

Taxpayers are allowed to offset capital gains (such as from the sa of stocks) with capital losses. If capital losses exceed capital gains f the year, up to $3,000 of losses can be deducted from other incon such as wages. Any loss greater than that can be carried forward future years. It's important to remember that stocks you've owned more than one year (called long-term) must be grouped together f purposes of calculating the capital gain or loss. The same is true f stocks held for one year or less (short-term).

Here's the strategy. When you identify stocks in your portfolio that have lost value and are no longer worth holding, consider selli those securities and offset all but $3,000 of the loss by also selling stocks that have gained value. This is known as "tax loss harvesting, and it can be an effective method for rebalancing your portfolio without paying capital gains taxes.

You can often manage the size of your gain or loss when you decide to sell some, but not all, of a particular stock or mutual fund. To do this, you must have kept good records of the date and the price for each share purchase. By selling the highest cost shares first, you'll minimize your taxable gain or maximize your loss. You must specify the particular shares you are selling at the time you sell.

On the other hand, some investors see this market as a buying opportunity. If you are considering an investment in mutual funds, pay special atter tion to the fund's proposed date for capital gains distributions. Mutual fund generally distribute all capital gains to investors toward the end of the year. If you purchase a mutual fund just before a distribution date, you will receiv the distribution and be required to include it in your taxable income. Since the price of the fund shares before and after a dividend distribution reflect the amount of the dividend, you are actually paying income tax on part of your own purchase price. To avoid this outcome, call the fund and ask for the ex-dividend date and the estimated payout and make your purchase aft that date.

Retirees may also have investment decisions to make this year. If you have a retirement plan that is currently subject to the "required minimum distribution" (RMD) rules, you should note that RMDs for 2009 have been suspended. This means that instead of liquidating and withdrawing the funds, you can leave your investments intact to help recover from la year's devastating losses. This is also true for those who inherited a retirement account subject to RMD rules.

For assistance with the year-end tax planning connected with you investments, give our office a call. ❑

Plan for next year's Roth IRA change

On the Chinese calendar, 2010 is the Year of the Tiger. On the U.S. tax calendar, 2010 may be the Year of the Roth. Why? Because Roth IRAs become more accessible next year. That's when the $100,000 income limit currently restricting the conversion from a traditional IRA to a Roth is repealed. Beginning January 1, 2010, you'll be able to convert to a Roth no matter what your income is.

The change comes from the *Tax Increase Prevention and Reconciliation Act* (TIPRA), a law signed in 2006. TIPRA also eliminates the prohibition against converting to a Roth for those married taxpayers who file separate returns. Starting next year, those individuals will be able to take advantage of the new rules too.

Though the revised rules take effect in 2010, the time to start planning is now. One reason: Even if you're ineligible for a Roth this year, it may be a smart move to make a 2009 contribution to a nondeductible traditional IRA, then convert the account to a Roth next year.

The first question to ask

Is converting a good idea? If it made sense before and you were unable to do so only because of the income limitation, the answer is probably yes. Switching gives you access to the benefits of Roth accounts. Those benefits include tax- and penalty-free distributions, both of which generally kick in once you're 59½ and have met the five-year holding requirement.

In addition, Roths offer estate planning advantages. For example, unlike traditional IRAs, you're not required to withdraw specified amounts from a Roth each year once you reach age 70½. The same is true when your spouse inherits the account as your designated beneficiary. Other heirs must take distributions, but the account balance can typically be withdrawn over a number of years.

The conversion to a Roth does have a cost. When you have no basis in your traditional IRA – for instance, you deducted your original contributions on prior tax returns – you'll have to add the entire amount converted to your taxable income. That's another reason to start planning now, since the increase in income could have tax and nontax implications, such as reducing itemized deductions or affecting college financial aid.

Fortunately, TIPRA provides a one-time incentive to do a traditional to Roth IRA conversion in 2010.

The incentive works this way

If you want to do a conversion, here's a reason to consider doing it in 2010. You do not have to include the taxable portion of the conversion in your 2010 income. Instead you are allowed to report half of the income on your 2011 tax return and the remaining half on your 2012 tax return.

The deferral gives you a multi-year period to plan for, and pay, the tax. Just be aware that taking distributions from converted funds may have tax consequences.

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You can also choose to pay more quickly by making an election to report all of the conversion on your 2010 return. While prepaying seems counterintuitive, remember that present federal tax rates are set to expire December 31, 2010. Postponing income into future years could mean a bigger tax bill.

Your plans for retirement

There's another way tax rates can affect your decision about converting. Say you intend to retire and relocate to a state with low or no income tax, and you expect the move to reduce your overall tax rate. In that case, you may decide to delay or forgo making a conversion.

Converting involves other variables too, and it's important to weigh the pros and cons in your individual situation. Please give us a call if you would like to discuss the best strategy for you. ❑

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NOTE: This newsletter is issued annually to provide you with information about minimizing your taxes. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.