Midyear Tax Planning Letter

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Mr. Geimer began his career in internal audit working with two different Fortune 500 firms. He subsequently became a partner in a northern California CPA firm before moving to Sarasota in 1981. In 1984, Mr. Geimer left Touche Ross & Co. to cofound Boone Faist Geimer & Smith, P.A. Later, in 1992 he founded Larry Geimer & Associates CPA's, P.A., which then merged in 2005 with Kerkering, Barberio & Co., P.A.

Cash in on First-time Homebuyer Credit

Legislation enacted in 2008 created a temporary tax credit for so-called first-time homebuyers. Stimulus legislation enacted earlier this year extended the credit provision to cover qualified home purchases between 1/1/09 and 11/30/09 and made the maximum credit amounts a bit more generous. More importantly, the stimulus legislation also deleted a previous requirement to repay the credit over 15 years in most cases. For a qualified home purchase between 1/1/09 and 11/30/09, the maximum credit equals the lesser of: (1) 10% of the purchase price of a principal residence, (2) $8,000, or (3) $4,000 for those who use married filing separate status. The credit can be used to offset your entire federal income tax bill, including any Alternative Minimum Tax (AMT). The credit is also refundable. After your tax bill has been reduced to zero, you are allowed to collect any leftover credit amount in cash.

Basic Eligibility Rules. Eligibility for the credit is limited to those who have not owned a principal residence in the U.S. during the three-year period that ends on the purchase date for the residence for which the credit is claimed. The new residence must be used as your principal residence. If you are married, both you and your spouse must pass the three-year test. For a newly constructed home, the purchase date is considered to be the date you move in. Additional eligibility rules apply in certain circumstances. Please contact us if you want more information.

Phase-out Rule. The credit is phased out (reduced or completely eliminated) if your Modified Adjusted Gross Income (MAGI) is too high. The phase-out range for unmarried individuals and married individuals who file separately is between MAGI of $75,000 and $95,000. The phase-out range for married joint filers is between MAGI of $150,000 and $170,000.

Claiming Credit for 2009 Purchase on 2008 Return. If you make a qualified 2009 home purchase (by the 11/30/09 deadline), you can choose to treat the deal as if it occurred in 2008. That way, you can claim the credit on your 2008 Form 1040 and get the tax-saving benefit that much quicker. Contact us for details on taking advantage of this option.

Collect Tax Breaks for Buying New Vehicle

Thanks to the following tax breaks that won't be around forever and a buyer's market, now might be a very good time to purchase a new vehicle.

Vehicle Sales Tax Deduction. Stimulus legislation passed earlier this year created a new federal income tax *deduction* for state and local sales and excise taxes paid on new (not used) vehicles that are purchased (not leased) between 2/17/09 and 12/31/09. The write-off is limited to the amount of taxes on the first $49,500 of purchase price. You can claim the break whether you itemize or not, and it's allowed even if you owe the AMT. An IRS spokesperson recently confirmed that you can claim the deduction on as many vehicles as you care to buy within the designated time frame. Qualifying vehicles include almost all passenger autos, pickups, and SUVs as well as motorcycles and RVs. However, a phase-out rule can reduce or completely eliminate the break for higher-income taxpayers. Contact us for details.

Hybrid Vehicle Credit. A federal income tax credit is allowed for buying (not leasing) a qualifying new (not used) hybrid vehicle. The credit can be used to offset your 2009 federal income tax bill even if you owe the AMT, and high income won't disqualify you. Credits for most qualifying vehicles range from around $1,500 to $3,000, so they can make a meaningful difference. However, credits are phased out once the manufacturer has sold over 60,000 hybrids in the U.S. Credits for Toyota and Lexus hybrids disappeared after 2007, and credits for Honda hybrids vanished after 2008. Credits for Ford and Mercury hybrids are being phased out right now. You'll get a bigger credit for buying a Ford or Mercury hybrid before October 1. So far, full credits are still allowed for hybrids put made by Chrysler, GM, Mazda, and Nissan.

Lean-burn Diesel Vehicle Credit. A federal income tax credit is also granted for buying (not leasing) a new (not used) qualifying lean-burn diesel vehicle. The credit will offset your 2009 federal income tax bill even if you owe the AMT and regardless of how high your income might be. Lean-burn diesel credits are subject to the same phase-out rule as hybrid credits. They will be reduced and eventually disallowed after a manufacturer has sold 60,000 units (not an issue so far). Right now, you can find Audi, BMW, Mercedes, and Volkswagen diesels that qualify. Credits range from $900 to $1,800.

Leverage Standard Deduction by Bunching Deductible Expenditures

Are your 2009 itemized deductions likely to be just under, or just over, the standard deduction amount? If so, consider the strategy of bunching together expenditures for itemized deduction items every other year, while claiming the standard deduction in the intervening years. The 2009 standard deduction for married joint filers is $11,400; the magic number for single filers is $5,700; it's $8,350 for heads of households.

For example, say you're a joint filer whose only itemized deductions are about $4,000 of annual property taxes and about $7,000 of annual home mortgage interest. If you prepay your 2010 property taxes by December 31 of this year, you could claim $15,000 of itemized deductions on your 2009 return ($4,000 of property taxes for this year, plus another $4,000 for the 2010 bill, plus $7,000 of mortgage interest). Next year, you would only have the $7,000 of interest, but you can claim the standard deduction next year (which will probably be pretty close to the $11,400 figure that applies for this year). Following this strategy will cut your taxable income by a meaningful amount over the two-year period (this year and next). Then, you can probably repeat the drill all over again in 2011 and 2012.

Examples of other deductible items that can be bunched together every other year to lower your taxes include the interest due with your January home mortgage payment, charitable contributions, and state income tax payments. But, watch out for AMT as state income and property taxes are not deductible for AMT purposes.

Consider Deferring Income

It may also pay to defer some taxable income from this year into next year, especially if you expect to be in a lower tax bracket in 2010. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2010. You can also postpone taxable income by accelerating some deductible business expenditures into this year. Both moves will defer taxable income from this year until next year. Deferring income may also be helpful if you're affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (such as itemized deductions, personal exemption deductions, the child tax credit, the education tax credits, and so forth). By deferring income every other year, you may be able to take more advantage of these breaks every other year.

Note: For higher-income taxpayers, it may not be advisable to repeat the income deferral drill in 2010 because pushing income from 2010 into 2011 could expose them to higher marginal tax rates in 2011. For that year, it is widely expected that the top two federal income tax rates will be increased to 36% and 38.6% (up from the current 33% and 35%).

Time Investment Gains and Losses and Consider Being Bold about It

As you evaluate investments held in your taxable brokerage firm accounts, consider the impact of selling appreciated securities. The maximum federal income tax rate on long-term capital gains from 2009 securities sales is only 15%. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling. On the other hand, now may be a good time to cash in some long-term winners to benefit from historically low tax rates.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end can be a good idea too. The resulting capital losses will offset capital gains from other sales this year, including short-term gains from securities owned for one year or less. You may have significant short-term gains if you bought into the stock market before this year's big uptick. The bottom line is that you don't have to worry about paying a high tax rate on short-term gains if you have enough capital losses to shelter those short-term gains.

If capital losses for this year exceed capital gains, you will have a net capital loss for 2009. You can use that net capital loss to shelter up to $3,000 of this year's high-taxed ordinary income from salaries, bonuses, self-employment, and so forth ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

Important Point: Selling enough loser securities to create a net capital loss that exceeds what you can use this year also might make sense. You can carry forward the excess net capital loss to 2010 and beyond and use it to shelter both short-term gains and long-term gains recognized in those years. This will give you extra investing flexibility in 2010 and beyond because you won't necessarily have to hold appreciated securities for over a year to get better tax results. Remember: It is widely expected that the maximum federal income tax rate on long-term capital gains will be increased to 20% for 2011 and beyond (up from the current 15%). Also, the top two federal rates on ordinary income (including short-term capital gains) are widely expected to be increased for 2011 and beyond to 36% and 39.6% (up from the current 33% and 35%). Contact us if you want help in identifying your best tax-smart options in a world where future tax rates are uncertain.

For the Charitably Inclined: Sell Loser Shares and Giveaway the Resulting Cash; Giveaway Winner Shares

Say you want to make some gifts to favorite relatives (who may really be hurting financially) and/or charities (ditto). You can make gifts in conjunction with an overall revamping of your holdings of stocks and equity mutual fund shares held in taxable brokerage firm accounts. Here's how to get the best tax results from your generosity.

Gifts to Relatives. *Don't* give away loser shares (currently worth less than what you paid for them). Instead sell the shares, and take advantage of the resulting capital loss. Then, give the cash sales proceeds to the relative. *Do* give away winner shares to relatives. Most likely, they will pay lower tax rates than you would pay if you sold the same shares. In fact, relatives who are in the 10% or 15% federal income tax brackets will generally pay a 0% federal tax rate on long-term gains from shares that were held for over a year before being sold. (For purposes of meeting the more-than-one-year rule for gifted shares, they get to count your ownership period as well as their own, however brief.) Even if the shares are held for one year or less before being sold, your relative will probably pay a lower tax rate than you would (typically only 10% or 15%). However, beware of one thing before employing this give-away-winner-shares strategy. Gains recognized by a younger relative who is under age 24 may be taxed at his or her parent's higher rates under the so-called Kiddie Tax rules (contact us if you're concerned about this issue).

Gifts to Charities. The strategies for gifts to relatives work equally well for gifts to IRS-approved charities. So sell loser shares and claim the resulting tax-saving capital loss on your return. Then, give the cash sales proceeds to the charity and claim the resulting charitable write-off (assuming you itemize deductions). As you can see, this idea results in a double tax benefit (tax-saving capital loss plus tax-saving charitable contribution deduction). With winner shares, give them away to charity instead of giving cash. Here's why. For publicly traded shares that you've owned over a year, your charitable deduction equals the full current market value at the time of the gift. Plus, when you give winner shares away, you walk away from the related capital gains tax. So, this idea is another double tax-saver (you avoid capital gains tax on the winner shares, and you get a tax-saving charitable contribution write-off to boot). Because the charitable organization is tax-exempt, it can sell your donated shares without owing anything to the IRS.

Convert Traditional IRA into Roth IRA

Here's the best scenario for this idea: Your traditional IRA is (or was) loaded with equities and took a major beating during the stock market downturn. So, your account is now worth a lot less than it once was. Correspondingly, the tax hit from converting your traditional IRA into a Roth account right now would also be a lot less than before. Why? Because a Roth conversion is treated as a taxable liquidation of your traditional IRA followed by a nondeductible contribution to the new Roth account. While even the reduced current tax hit from converting is unwelcome, it may be a small price to pay for future tax savings. After the conversion, all the income and gains that accumulate in your Roth account, and all withdrawals, will be totally free of any federal taxes—assuming you meet the tax-free withdrawal rules. In contrast, future withdrawals from a traditional IRA could be hit with tax rates that are much higher than today's rates.

Of course, conversion is not a no-brainer. You have to be satisfied that paying the up-front conversion tax bill makes sense in your circumstances. In particular, converting a big account all at once could push you into higher 2009 tax brackets, which would not be good. You must also make assumptions about future tax rates, how long you will leave the account untouched, the rate of return earned on your Roth account investments, and so forth. To be eligible for a Roth conversion this year, your 2009 adjusted gross income cannot exceed $100,000. In 2010, the $100,000 restriction will go away unless Congress changes the deal. Also, taxes on income recognized in 2010 from a Roth conversion are deferred until 2011 and 2012. So, 2010 may be an ideal time to convert, assuming your account doesn't appreciate substantially in the mean time. If the Roth conversion idea intrigues you, please contact us for a full analysis of all the relevant variables.

Watch Out for Alternative Minimum Tax

While many recent tax-law changes have been helpful in reducing your regular federal income tax bill, they didn't do much to reduce the odds that you'll owe the dreaded AMT. Therefore, it's critical to evaluate all tax planning strategies in light of the AMT rules before actually making any moves. Because the AMT rules are complicated, you may want our assistance. We stand ready to help!

Take Advantage of Generous But Temporary Business Tax Breaks

Several favorable business tax provisions have a limited shelf life that may dictate taking action between now and year-end. They include the following.

Bigger Section 179 Deduction. Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2009, the maximum Section 179 deduction is $250,000 (same as last year). For tax years beginning in 2010, however, the maximum deduction is scheduled to drop back to about $130,000 (depending on the inflation adjustment). Various limitations apply to the Section 179 deduction privilege, so please contact us if you want more information.

50% First-year Bonus Depreciation. Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software acquired and placed in service by December 31 of this year. The first-year bonus depreciation break is scheduled to expire at year-end unless Congress takes further action. Contact us if you want more details about this generous, but temporary, tax break.

Longer Carryback Period for Net Operating Losses (NOLs). Stimulus legislation passed earlier this year allows qualifying small and medium-sized businesses to carry back Net Operating Losses (NOLs) generated in tax years beginning *or ending* in 2008 for up to five years (versus the two-year carryback rule that usually applies). Therefore, if your qualifying business uses a fiscal tax year (say one ending in October), you may still have time to take actions that will create or increase an NOL for the current tax year. That NOL can then be carried back for up to five years to recover taxes paid in those years.

Note: 50% first-year bonus depreciation deductions for qualifying assets placed in service between now and December 31 can create or increase an NOL. However, Section 179 deductions cannot. Please contact us for details on the interaction between asset additions and NOLs.

Don’t Overlook Estate Planning

The federal estate tax exemption for 2009 is a relatively generous $3.5 million (up from $2 million last year). For 2010, the federal estate tax is scheduled to be repealed, but just for that one year. However, it now seems very clear that the promised repeal won’t happen. The more likely scenario is that we will continue to have a federal estate tax for 2010 and beyond with an exemption around the current $3.5 million figure, but nobody knows for sure. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan. We hope to have more certainty about the rules that will apply for 2010 and beyond before year-end. Please stay tuned, and contact us later this year for updated information.

In any case, whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you can give each of them up to $13,000 this year. Your spouse can do the same. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So, the sooner you start an annual gifting program, the better.

Note: With many asset values now at much lower levels than in the recent past, the current environment is actually great for tax-smart gift giving, assuming you have more than you need. Contact us for more information on the best ways to avoid estate taxes for someone in your situation.

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