MargolisBecker
The Business and Management Advisors

TAX PLANNING UPDATE
Summer 2010

Dear Clients and Friends,

SIGNIFICANT TAX CHANGES ARE ON THE HORIZON FOR 2011

This letter is being sent to you as a reminder that a mid-year tax review is vital if you want to keep your 2010 and 2011 taxes under control. At the end of 2010, most of the provisions in the *Economic Growth and Tax Relief Reconciliation Act of 2001* will "sunset" or expire. Only those provisions extended or made permanent by later tax legislation will remain effective in 2011. *What this means is that income taxes will be higher in 2011 unless Congress decides otherwise. Debate in Congress will be heating up from September, up through the elections in November, and by year end. Estate taxes, which by a fluke of the law, may be Ø for 2010 will also be hotly debated in the coming months.* That fact makes tax planning crucial for 2010, and presents opportunities and pitfalls that should be analyzed if you want to keep your taxes as low as possible.

Hit your tax-cutting target with smart <u>mid-year</u> planning.

With the tax law changes currently swirling around Congress, tax planning for 2010 is like trying to hit a moving target. Major legislation has already been passed this year, such as the *HIRE Act* to stimulate job growth and health care reform to cover the uninsured. These laws contain tax provisions - some very targeted and short-lived, while others are wide-reaching and spanning a decade or more. But even in this period of uncertainty, there are definite steps you can take to score a tax-cutting bull's eye.

Watch your withholding and estimated taxes

A few tax-smart moves remain the same every year, such as maximizing your retirement account contribution, keeping good records, and reviewing your tax withholding and/or quarterly estimated payments. An added twist this year might be how the economic and job market conditions affect your withholding or tax estimates. If you recently had a job change, received unemployment benefits (which are taxable over 2 years), or made an emergency withdrawal from your retirement account, you may need to adjust your withholding. A new home mortgage, change in dependents, or a forgiven business loan can also move you off track.

Washington, DC
10001 Derekwood Lane, Suite 210
Lanham, MD 20706
t 888.577.1717 p 301.577.1313 f 301.577.0431

Philadelphia
8 Tower Bridge, 161 Washington St., Suite 430
Conshohocken, PA 19428
t 888.577.1717 p 610.667.4310 f 610.667.2099

Estimating Your Taxes

Targeting your estimated taxes is particularly important in 2010. Last year, certain taxpayers could base their estimates on 90% of the previous year's taxes. This year, the old rules are back. The combination of tax withheld and quarterly estimated taxes paid-in must be the lesser of 100% of last year's tax or 90% of the current year tax liability. However, if your adjusted gross income was at least $150,000 for 2009, you must have at least the lesser of 110% of last year's tax or 90% of the current year tax liability paid-in.

Review your retirement plan

For Age 70½ and Over

Back in the mix for 2010 are required minimum distributions (RMDs) from retirement plans. After a one-year hiatus, taxpayers age 70½ and older (and those who inherited a retirement account) are again required to take taxable annual distributions. 2010 distributions must be taken by December 31, 2010. Taxpayers who turn 70½ in 2010 may choose to delay taking their first distribution until April 1, 2011. However, a non-recurring catch-up distribution must also be taken by December 1, 2011. Note that annual distributions are not required for Roth IRAs.

Converting Traditional IRAs to Roth IRAs

On a positive note, the $100,000 income limitation for converting a traditional IRA to a Roth IRA is gone, opening the door to many taxpayers who were otherwise excluded from this popular strategy. Furthermore, with the possibility of income tax rate increases for 2011, this year may present an excellent opportunity to convert your traditional IRA to a Roth IRA. For example, for high income individuals who will be taxed at the 35% maximum Federal tax rate, if the 39.6% tax bracket is restored in 2011 (as most experts are saying), taxpayers can realize a maximum discount of more than 11% on Federal tax, depending on their future tax situations.

If your tax bracket is expected to be the same or lower in 2011 and 2012, however, you can elect to defer paying tax on the conversion by reporting ½ of the converted value for each of those years on your tax return. Note that tax rates will most likely increase after this year, so any potential tax savings will be offset by higher tax rates.

As we've observed in the last few years, stock markets can also decline, causing retirement funds to fall in value and leaving taxpayers with a higher tax bill than expected. For example, if you converted to a Roth IRA this year when the value was at $100,000 and by April 15, 2011, the value dropped to $70,000, you'll be paying tax on the converted value of $100,000, not the lower fair market value of $70,000. To avoid getting stuck, file an extension for tax year 2010. You have until October 15, 2011 to see if the value of your IRA recovers, or you may choose to convert the Roth IRA back to a traditional IRA through a re-characterization, leaving no taxable Roth conversion income to report for 2010.

Contribution Limits

Contribution limits for retirement plans stay the same in 2010. For 401(k) and 403(b) plans, the maximum you can put away is $16,500. If you're 50 or older, a catch-up contribution is allowed and you can contribute up to $22,000. The contribution limit for SIMPLE plans is $11,500 ($14,000 if you're 50 or older).

Maximize your deductions and credits

Many itemized deductions and tax credits are in Congressional limbo right now, including some tax breaks that have expired or are about to expire but might be renewed. To minimize your taxes, you need to stay aware of the status of credits and deductions and be prepared to adjust your planning accordingly.

Itemized Deductions and Personal Exemptions for High Income Taxpayers

One definite tax break for 2010: the phase-out of itemized deductions and personal exemptions for high-income taxpayers has been removed. Under the 2001 tax law, the full deduction for personal exemptions and itemized deductions for higher-income taxpayers have been gradually restored. Effective this year, high-income taxpayers are entitled to the full $3,650 deduction for each personal exemption they take, and will realize their total itemized deductions with no further reductions through a phase-out based on income. As with most other provisions in the 2001 tax law, this change ends after December 31, 2010, and itemized deductions and personal exemptions will again be limited for high-income taxpayers in 2011.

Homeowners' Energy Tax Credit

If you missed out on the homebuyer tax credit, you are out of luck unless Congress decides to bring it back. But homeowners can still score an energy tax credit. For tax years 2009 and 2010, you can receive a tax credit of 30% of the cost of qualifying home improvements made over the two-year period. The maximum credit is $1,500 for both years combined. For example, if you claimed a credit of $1,000 for tax year 2009, the maximum credit that you can claim for 2010 is $500. Qualifying improvements include a new heating and air conditioning system, insulation, doors, and windows. Energy tax credits for big-ticket items such as geothermal systems are also available.

Rebalance your Portfolio (to be more tax-efficient)

For 2010, the maximum long-term capital gains tax rate for most investments and for qualified dividends is 15%. The rate falls to zero if you're in the 10% or 15% tax brackets for ordinary income. Those two brackets currently apply when you're married filing jointly and your taxable income is less than $68,000 ($34,000 if you're single).

After this year, selling appreciated investments may cost you more in taxes as the long-term capital gains rate is expected to be increased to at least 20% after 2010. Also, dividends are expected to be taxed at ordinary income tax rates instead of the lower long-term capital gains rate. As a result, one should cash in gains this year, right? It depends. Making sales in the current year to take advantage of lower rates can put you in a higher bracket and reduce your itemized deductions and credits. For example, since the nondeductible portion of medical deductions (7.5% of adjusted gross income) and miscellaneous expenses (2% of adjusted gross income) are based on income, any potential tax deductions in these areas will be reduced.

As an alternative to selling, there are strategies that might better suit your overall financial goals.

If it is likely that dividends will once again be taxed at your ordinary income tax rate starting next year, you can choose to invest in stocks and mutual funds with a focus more on growth potential instead of paying current income through dividends. Check with your financial advisor to see if it's feasible for you.

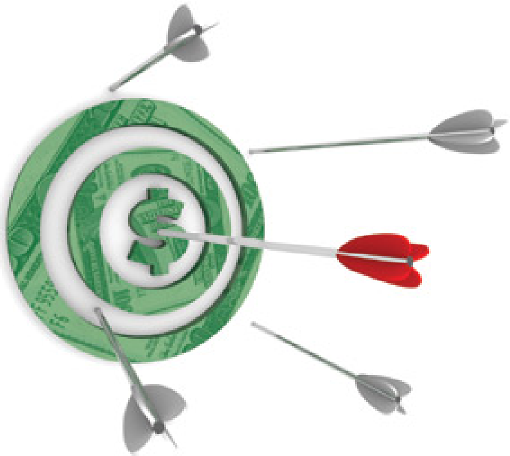
Another strategy is to consider investing in tax-free municipal bonds. For a Federal tax exempt municipal bond paying at 2%, equivalent taxable yields will increase from 3.07% to 3.31% for a taxpayer whose tax bracket went from 35% in 2010 to 39.6% in 2011.

As you rebalance your portfolio over the course of 2010, you might also consider increasing your investment in mutual funds with low turnover rates. Here again, you'll reduce taxable capital gains in future years.

Gifts of stock to certain family members in lower tax brackets and donations of appreciated assets to your favorite charity are other viable alternatives for reducing the amount of capital gains tax you'll pay now and in the future.

Mind your business (taxes)

The *HIRE Act*



New legislation in 2010 and tax increases expected for 2011 have brought a fresh set of opportunities and challenges for businesses. The *HIRE Act* passed in March gives employers a tax incentive to hire workers who have been unemployed for awhile. Employers can receive an exemption from social security payroll taxes for every qualified worker that was hired February 3, 2010 and before January 1, 2011. For new hires kept on the payroll for at least 52 weeks, employers may qualify for a tax credit for each retained worker of the lesser of $1,000 or 6.2% of wages paid during the 52-week period.

Note that the payroll tax forgiveness provided in the law does not apply to the Medicare portion of the tax. A newly hired employee cannot also displace a current employee unless that employee quit or was fired for cause (layoff due to recession is a valid cause). Relatives of the employer are not considered qualified employees for these tax breaks.

The *HIRE Act* also reinstates for 2010 the $250,000 first year expensing limit for purchasing new or used business equipment. Unfortunately, the 50% bonus depreciation on new equipment purchases has not been extended yet. Stay tuned…

Health Care Reform

The health care reform legislation passed in March will bring tax changes for years to come. One immediate benefit is a tax credit available for small businesses that provide qualified employee health insurance benefits. The credit is generally available to small companies and tax-exempts that pay at least 50% of the cost of single coverage for their employees. For 2010, the maximum credit is 35% of premiums paid by small businesses and 25% of premiums paid by tax-exempt organizations.
The maximum credit goes to those employers with ten or fewer full-time equivalent employees who pay annual average wages of not more than $25,000. The credit gradually phases out for firms with average wages between $25,000 and $50,000 and between 10 and 25 full-time equivalent employees.

C Corporations

Does your business operate as a regular "C" corporation? Think about making dividend payments during 2010. In a typical tax planning year, dividend distributions are unappealing because they're not a deductible business expense and you have to report them on your personal tax return as income; but the expiration of preferential tax rates for dividends at the end of 2010 could make this a good time to pay dividends from your corporation.

May we help you?

Developing a solid tax plan from year to year is difficult enough, but responding to this year's fluid tax law environment is especially challenging. Even so, the best tax tip remains the same: stay in touch with us. We will be monitoring legislation for changes that could affect your tax and business situation, and can assist you in planning your best course of action. For a mid-year tax review, give us a call today.

NOTE: This newsletter is issued at midyear to provide you with information about minimizing your taxes. 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.