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YEAR END TAX PLANNING FOR INDIVIDUALS

The midterm elections have altered the Congressional landscape, with Republicans winning control of the House of Representatives and picking up seats in the Senate. Even so, it is premature to know exactly how this will impact open income tax issues for 2010 and 2011.

Specifically, when the "lame-duck" Congress returns later this month, it must opt whether to "patch" the alternative minimum tax (AMT) for 2010 (increase exemption amounts, and allow personal credits to offset the AMT), as it has done in past years. It also must ascertain whether to retroactively extend a number of tax provisions that expired at the end of 2009. These include, for example, the election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes, and the additional standard deduction for State and local real property taxes.

Additionally, and probably what has received the most media attention, is whether Congress will extend the Bush-era tax cuts for some or all taxpayers. Without Congressional action, individuals will face higher marginal tax rates on their income and capital gains equal to the rates imposed during the Clinton era. Also, unless altered, the estate tax, which is not in effect this year, will return next year with a 55% top marginal rate.

In short, year-end planning—which always involves some educated guesswork—is a bigger challenge this year.

The Closely Held Business Team attorneys at Harrang Long Gary Rudnick are committed to serving the needs of business owners in a responsive and proactive manner. They understand the challenges and the opportunities provided by the law in today's business climate, and are focused on the advancement of each client's success in business.

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That said, we have compiled a checklist of actions that can help you mitigate individual income tax exposure if you act prior to December 31st. These moves may benefit you regardless of what decisions the lame-duck Congress makes concerning the aforementioned tax issues. Although not all suggestions will apply in your particular situation, we perceive there is something for everyone. Please consider the following:

1. ***Stock Portfolio*** - Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, and then buy back the same securities at least 31 days later. Due to the fact-specific nature of such analysis, please contact us if you think this may be applicable so we can further explore such strategy.

2. ***Withholding*** - Increase withholding to offset potential application of the understatement penalty for federal estimated tax. Doing so may reduce or wholly eliminate the penalty.

3. ***Retirement Plans and Withholding*** - Take an eligible rollover distribution from a qualified retirement plan before year end to offset the potential application of the understatement penalty for federal estimated tax, and the aforementioned increased withholding option is unavailable or will not sufficiently cover the exposure. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2010. You can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2010, but the withheld tax will be applied pro rata over the full 2010 tax year to reduce previous underpayments of estimated tax.

4. ***Home Improvements*** - Make energy saving improvements to your primary residence, such as putting in extra insulation or installing energy saving windows or buying and installing an energy efficient furnace. Such expenditures qualify for a 30% tax credit. The total (aggregate) credit for energy efficient improvements to the home in 2009 and 2010 is $1,500. Unless Congress acts, this tax break will expire at the end of this year. Additionally, substantial tax credits are available for installing energy generating equipment (such as solar electric panels or solar hot water heaters) to your home (this break stays on the books through 2016).

5. ***IRA Conversion*** - Convert your traditional IRA into a Roth IRA if doing so is expected to produce better long-term tax results for you and your beneficiaries. Distributions from a Roth IRA can be tax-free but the conversion will increase your adjusted gross income for 2010. However, you will have the choice of when to pay the tax on the conversion. You can either: (i) pay the tax on the conversion when you file your 2010 return in 2011; or (ii) pay half the tax on the conversion when you file your 2011 return in 2012, and the other half when you file your 2012 return in 2013.

6. ***Small Business Stock Acquisition/Disposition*** - Purchase qualified small business stock ("QSBS") prior to year end. There is no tax on gain from the sale of such stock if it is: (i) purchased after September 27, 2010 and before January 1, 2011; and (ii) held for more than five years. In addition, such sales will not cause AMT preference problems. To qualify for these breaks, the stock must be issued by a regular C-corporation with total gross assets of $50 million or less, and a number of other technical requirements must be met.

7. ***Required Minimum Distributions*** - Take required minimum distributions (RMD) from your IRA or 401(k) plan (or other employer-sponsored retired plan) if you have reached age 70 1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. A temporary tax law change waived the RMD requirement for 2009 only, but the usual withdrawal rules apply full force for 2010. Therefore, individuals age 70 1/2 or older generally must take the required distribution amount out of their retirement account before the end of 2010 to avoid the penalty. If you turned age 70 1/2 in 2010, you can delay the required distribution to 2011, but if you do, you will have to take a double distribution in 2011—the 2010 required amount

plus what is mandated for 2011. Think twice before delaying 2010 distributions to 2011—bunching income into 2011 might push you into a higher tax bracket, or have a detrimental impact on various income tax deductions that are phased out at higher income levels.

8. ***Gifting*** - Make annual exclusion gifts before year end to save gift tax (and estate tax if it is reinstated). You can gift $13,000 (couples can jointly gift $26,000) in 2010 or 2011 to an unlimited number of individuals free of gift tax. However, you cannot carry over unused exclusions from one year to the next. The transfers also may same family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the "kiddie" tax.

Required Tax Disclaimer and Additional Tax and Professional Advice

Internal Revenue Code Circular 230 requires us to disclose that this is not a reliance opinion. This is not intended or written by us to be used, and it cannot be used by you, for the purpose of avoiding penalties that may be imposed on you or another taxpayer, and you should consult directly with your tax professional.

Our attorneys have significant income tax experience in all of the aforementioned areas. If you have questions about the aforementioned, or how it may apply to your circumstances, please do not hesitate to contact our closely held business attorneys Jonathan D. Mishkin, LL.M., Randall L. Duncan, David Denecke or John T. Witherspoon, and we would be pleased to provide guidance and assistance.

Please stay tuned as next week we will be releasing information concerning "Year End Tax Planning for Business Owners".

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