TAX TALK

Goldburd & Co. LLP
Certified Public Accountants

Winter 2010

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 (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 the lame duck session after the November elections. 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.

Take advantage of lower capital gains rates. If you have investments that have appreciated in value and you have been contemplating selling soon, now may be better than later. For 2010, long-term capital gain is taxed at a maximum rate of 15 percent (for assets held longer than one year). If you're in the 10 to 15 percent marginal income tax brackets in 2010, a zero percent rate applies. That is, you will pay no tax when you dispose of the assets. However, these beneficial rates will disappear after 2010. For 2011, the maximum tax rate on long-term capital gain is scheduled to rise to 20 percent, with a 10 percent rate applying to taxpayers in the lowest brackets. Thus, selling off any of your capital gains assets in 2010 is significantly more beneficial tax-wise then delaying the sale and paying higher rates in 2011 or thereafter.

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.

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.

AMT planning

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.

Congress has not as of yet enacted a “patch” to AMT for 2010 and it is unclear if they will take up an AMT patch during the lame duck session. Unless they do, the exempt amounts will fall to $33,750 for individuals; $45,000 for married couples filing jointly; and $22,500 for married individuals filing separately. Your year-end planning should include accounting for a lack of an AMT patch in the case that Congress does not act.

Expired tax incentives

Some tax breaks that you may have claimed on last year’s return may have expired and not be applicable to your 2010 return. A number of individual tax incentives expired at the end of 2009 and unless Congress retroactively extends them for 2010, you will not get their benefit on your return. While Congress may act to retroactively extend some, or all, of these popular incentives, you should be aware that the following tax breaks have expired and are currently not available for 2010:

-- The additional standard deduction for state and local property taxes for non-itemizers;
-- The election to itemize state and local sales taxes instead of state and local income taxes;
-- The higher education tuition deduction of up to $4,000;
-- The teacher’s classroom expense deduction of up to $250; and
-- The exclusion from gross income of up to $2,400 of unemployment benefits.

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 to 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) carry-forwards 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.

Taxpayers may also claim additional bonus depreciation of $8,000 for the purchase of cars and light trucks/vans, making the total deductible amount for 2010 $11,060 for passenger cars and $11,160 for trucks. Generally, these amounts are reduced proportionately if use of the automobile or truck is less than 100 percent business-related. However, these higher amounts will not be available after December 31, 2010.

Payroll tax exemption

Employers that hire certain unemployed individuals after February 3, 2010, and before January 1, 2011 may qualify for a 6.2 percent payroll tax incentive. The incentive exempts businesses from paying the employer's share of Social Security taxes on wages paid to qualified new hires after March 18, 2010 and before January 1, 2011. Some employers mistakenly believe that they cannot claim the incentive unless they had previously laid off employees. This is incorrect. The payroll tax exemption can apply to wages paid to any qualified employee.

Not every new hire may qualify for the incentive. Generally, a qualified employee is an individual who was unemployed or who was employed but worked 40 hours or less during the 60-day period ending on the date of new employment. The individual also must not have been hired to replace another employee of that employer, unless the other employee separated from employment voluntarily or was terminated for cause. Certain family members of the employer or employees who are related in other ways to the employer are not qualified employees for purposes of the payroll tax exemption.

Worker retention credit

Related to the payroll tax exemption is a new but temporary worker retention credit. An eligible employer may claim the credit for each new hire who meets certain retention requirements. A retained worker is a qualified employee (as defined for purposes of the payroll tax exemption) who remains an employee for at least 52 consecutive weeks, and whose wages (as defined for income tax withholding purposes) for the last 26 weeks equal at least 80 percent of the wages for the first 26 weeks. The amount of the credit is the lesser of $1,000 or 6.2 percent of wages (as defined for income tax withholding purposes) paid by the employer to the retained worker during the 52 consecutive week period. The credit may be claimed for a retained worker for the first taxable year ending after March 18, 2010 for which the retained worker satisfies the 52 consecutive week requirement.

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.

Code Sec. 45R tax credit

The Code Sec. 45R credit has many restrictions. For example, many small businesses may employ family members of the owner(s). Certain family members are excluded from the definition of employee for purposes of the Code Sec. 45R credit. A sole proprietor, a partner in a partnership, a shareholder owning more than two percent of an S corporation, and any owner of more than five percent of other businesses also are not considered employees for purposes of the credit.

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.

Give us a call

All of the tax opportunities and considerations at this time of year can be a lot to remember, and the details of all these provisions can make it even more complicated. Fortunately, you won't have to remember all of them by yourself – that is why you hired us. The two most important pieces of tax advice for any year are to keep good records and ask questions. We look forward to hearing from you.

If you are projected to owe additional income tax, a tax projection can help determine which tax-minimizing strategies should be used before the end of the year to reduce or eliminate any tax due. If you are due a refund, we can ensure your tax return is filed as early as possible to allow you to receive your refund and enjoy your money more quickly.

If you need additional information on any of the above items or wish to speak with us directly about your tax picture for 2010, please do not hesitate to contact us at (212) 302-8970.

In addition if you feel that your friend or business associates could benefit from this newsletter, please feel free to pass it on to them.

To view our newsletters, please visit us on the web at www.goldburd.com.