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Lynn's Top Five 2010 Year-End Tax Planning - A Time for New Strategies

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You know the old adage: what you don't know can hurt you? This year, as never before, words to heed as we enter into our final descent for year-end tax planning! Why? Here's the cautionary tale: we might be in the best tax rate environment of our lives in 2010. There's nothing solid and comfy to hold out for coming up. Tax rates everywhere we turn are poised to go up. Whether it's in the guise of a "fee" or a special assessment, loss of a deduction, credit phase outs, or just out and out rate increases, it's not a pretty picture.
So this year --- hang on to your hats --- you might want to accelerate income and defer expenses! First time you ever heard me say that! Here are five tips and thoughts that may be a bit off the beaten track, for you to muse on.

1) Roth IRA conversions: okay, MUST start here, because some of you are actually experiencing negative taxable income this year. Why? If you have retired, been laid off, your taxable investment income is most likely very low and you may still have a hefty mortgage, property taxes, medical expenses and the like. To the extent you have negative taxable income, you can convert some (maybe all) of your pre-tax IRA and not pay a penny in tax. Run the projections and check it out. Even those in a very low bracket might say to themselves, heck, I've got so little to lose, I'm going for it. The amount converted may be subject to tax, so discuss your situation with your financial and tax advisor before you convert.

2) Nightmare on AMT street: Alternative Minimum Tax --- aka AMT --- strikes horror and fear far and wide, and well it should. It defies guessing, and sneaks up in years that are seemingly innocent and worry free. Imagine my shock, when chatting with long-time friend and colleague, Linda LaHonta, CPA, (with her practice in Lafayette) as she clued me into the following "tidbit" that I'll share here with you: "A big concern of mine that isn't getting nearly as much press as the extension of the Bush tax cuts, is the alternative minimum tax "patch" that has not yet been approved for 2010. I read a statistic that said without this patch the AMT will affect 26 million people in 2010 vs. 4 million people in 2009. We live in an area where the AMT impacts many families. Without this patch they will see their federal taxes go up considerably in 2010. Congress has recently said that they are working on a bill immediately to put into place "temporary" relief this year. Great news! But this is still a concern. They need to come up with a permanent solution to the AMT because we can't be "patching" this thing at the 11th hour every year! People have a right to know what to expect of their tax liability for the year at the beginning of the year, not at the end, and be able to plan accordingly." Hear, hear, Linda!!! And my fear? Although they said they are working on a patch, do we trust them to do it? This is a government scrambling for every penny they can find.

3) Go ahead --- lock in as much capital gains as you can! Yup, you heard me right. This is a great tip for the many of you who have large, sometimes very large, capital losses that you are carrying forward to future tax years. Unless you have something important to save them for (perhaps the sale of a home with gain over $500K or a rental property you are not going to exchange into another), why not use them now? Personally, I'm worried about these huge losses being carried on so many taxpayers' books. I worry that Congress is going to limit the amount that can be carried forward either with respect to the amount or the number of years. If you can tidy up your portfolio or even sell and repurchase to reset basis higher (BE CAREFUL OF THE 30 DAY WASH SALE RULES!), why not? Be sure to figure in the costs of the transactions to make sure it's a financially beneficial approach. As Linda points out "given the potential increase to the long term capital gains tax rates I would suggest possibly taking gains in 2010 on investments held longer than one year rather than waiting."

4) Don't prepay your state income tax and other normally deductible expenses this year: The reason? It's back to the nasty AMT and also the thought that next year you'll probably be in a higher bracket. What you would normally prepay in December, such as your second property tax for the county's fiscal year, could actually net you 5% or more in tax savings by waiting until January. And, what's the flip side? Take in all the income you can this year! If you are self-employed, perhaps you bill early and book income in 2010. If they extend the FICA, aka social security tax (known as self-employment taxes for those who are self-employed) to be collectible on ALL earned income next year, as is currently being discussed, this MIGHT be a better taxable income year for you. Again, you need to do the math.

5) Tax laws that go "bump" in the night: Lions and tigers and VAT (Value Added Tax), oh my! We hear Congress increasingly revisiting the idea of a national flat sales tax. If they got rid of the income tax, many would applaud that move. However, lawmakers would most likely not go that clean route, since they use income tax legislation to create social and economic change. Instead, they'd have a sales tax, too! And what about 2013, when, according to Linda, "there will be a new 3.8% tax on investment income for certain taxpayers ($200,000 individual & $250,000 married filing joint)," which is basically the new health care surtax. Again, more fuel for enjoying our current tax rates and making some hay now.

Because of the incredible amount of uncertainty and nuances associated with year-end tax planning this year, you really need to do the math and not make any assumptions. Either work with your trusted tax advisor (or find a great new one, such as Linda LaHonta) or on your own, run the different scenarios and execute the actions that make the most sense for you. You've got time to think it through, and I encourage you to do so.

Here's some great news: Linda has agreed to join me Wednesday, January 26th at noon, for a free webinar that will focus on Tax Planning for 2011. The current session of Congress --- the lame duck session --- may be very busy creating new tax policy. We hope you will tune in and join us live so you can hear what she has to say about what they end up creating, and pose questions of your own. You can check my website: www.ballouplum.com and then tab CLIENT EVENTS to keep up with instructions to join this free webinar. You don't need to be a client to join us! We'll post instructions after the holidays. Or feel free to send me an email at: plan@ballouplum.com and we'll email instructions directly to you for this event.

Happy Tax Planning (oh, and Holidays, too!)

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