12221 Merit Drive, Suite 750
Dallas, TX 75251
Phone: 972.503.1040
Fax: 972.503.1120
www.bh-co.com

2010 YEAR-END TAX PLANNING

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 as well as provide immediate tax savings in the new year. This letter highlights some planning opportunities and challenges for individuals and businesses.

Individuals

The Economic Growth and Tax Relief Reconciliation Act of 2001 (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 have been extended for tall taxpayers through 2012 under the Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act).

A closely related planning consideration involves capital gains and dividends. Reduced capital gains and dividend tax rates were scheduled to expire after December 31, 2010, but have been extended through 2012 under the 2010 Tax Relief Act. Thus, through December 31, 2012, qualified capital gains and dividends are taxed at a maximum rate of 15 percent (zero percent for taxpayers in the 10 and 15 percent income tax brackets). The extension of the income tax and capital gains tax rates in general has prevented (or at least postponed until year-end 2012) the counterintuitive advice of accelerating income into 2010 because of the rate increases that had been scheduled for 2011. Both accelerating or postponing income and deductions continue as viable strategies. The goal: to even out tax liability between years in a way that gets your average tax rate over a number of years at its lowest possible level.

Many individuals also must prepare for the expiration of the Making Work Pay Credit (MWPC), which may be claimed up to a $400 maximum ($800 for joint filers) with a phaseout level starting at $75,000 ($150,000 for joint filers). 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. Congress, however, has replaced the MWPC with a tax benefit that for many wage earners will prove much more beneficial. The 2010 Tax Relief Act reduces the employee-share of OASDI (Social Security tax) from 6.2 percent to 4.2 percent for wages up to $106,800 earned in calendar year 2011. Unlike the MWPC, the 2011 payroll tax cut is not phased out based on adjusted gross income (AGI).

Congress also has extended a number of the temporary, but popular "tax extenders". Some of the most popular are the state and local sales tax deduction, the higher education tuition deduction and the teachers' classroom expense deduction, which expired at the end of 2009. Congress has retroactively extended these three incentives for the 2010 tax year and through December 31, 2011.

Congress also enacted an AMT patch for 2010 and 2011. In recent years, Congress has "patched" the AMT to prevent it from encroaching on middle-income taxpayers. For 2010, the exemption amounts are $47,450 for individual taxpayers and $72,450 for married taxpayers filing jointly. For 2011, the amounts are increased to $48,450 for individuals and $74,450 for married taxpayers filing jointly. Congress also made available for 2010 the application of nonrefundable personal credits to the full amount of an individual's regular tax or AMT. Timing so called "tax preference" items of income and deductions can sometimes lower overall AMT liability.

The federal estate tax was scheduled to revert to pre-EGTRRA rates for decedents dying after December 31, 2010. Under current law, the federal estate tax is abolished for 2010, replaced by a carryover basis at death regime. The 2010 Tax Relief Act revives the estate tax for decedents dying after December 31, 2009. The maximum estate tax rate is 35 percent with an exclusion amount of $5 million. The new estate tax regimes is only temporary though, and will sunset after December 31, 2012. The changing situation with the estate tax requires frequent re-evaluation of an estate plan. Lifetime gift-giving, ideally on an annual basis, should also form part of a master estate plan.

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 American Opportunity Tax Credit;
4. Casualty losses from qualifying events;
5. Tax incentives for job-search expenses; and
6. Expiration of COBRA premium assistance.

Businesses

Businesses, like individuals, can now be more certain in their 2010 year end, and 2011 new year, tax planning as a result of the Small Business Jobs Act of 2010 and the 2010 Tax Relief Act. The 2010 Tax Relief Act has extended and enhanced two valuable tax incentives for businesses: bonus depreciation and increased Code Sec. 179 expensing.

The 2010 Tax Relief Act has boosted 50-percent bonus depreciation to 100 percent for qualified investments made on or after September 9, 2010 and on or before December 31, 2011. The 2010 Tax Relief Act also makes 50-percent bonus depreciation available for qualified property placed in service after December 31, 2011 and on or before December 31, 2012. Certain long-lived property and transportation property is eligible for 100 percent depreciation if placed in service before January 1, 2013. .The Small Business Jobs Act also allows taxpayers to claim an additional $8,000 in first-year depreciation for the purchase of automobiles and light trucks.

Code Sec. 179 expensing allows small and mid-size businesses 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. The 2010 Tax Relief Act also provides for a $125,000 dollar limit and a $500,000 investment limit (both indexed for inflation) for tax years beginning in 2012.

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) carryforwards 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.

Businesses that hire new employees after February 3, 2010 and before January 1, 2011 may qualify for a special payroll tax exemption. The exemption effectively negates the employer's share of Social Security taxes paid on qualified new hires after March 18, 2010 and before January 1, 2011. While not directly reducing an employer's taxes, businesses should not ignore telling their employees about the benefits of a new payroll tax holiday given to employees for 2011 under the 2010 Tax Relief Act. In effect each work gets the equivalent of a two-percent raise for 2011. For wages of up to $106,800 earned during the 2011 calendar year, the employee's share of OASDI (Social Security tax) is reduced from 6.2 percent to 4.2 percent.

Businesses also may qualify for a worker retention tax credit. This credit is available if the business retains for at least 52 weeks a worker who was hired under the payroll tax exemption tax break.

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.

Making tax planning also more certain, Congress has extended a number of other poplar business tax incentives for the 2010 and 2010 tax years, including:

1. The research tax credit;
2. Brownfields remediation incentives;
3. Incentives for film and television production;
4. Code Sec. 199 domestic production activities deduction, potentially valuable but often under-utilized;
5. Work Opportunity Tax Credit; and
6. Energy tax incentives.

If you have any questions about the year-end planning opportunities and challenges we have highlighted, please contact our office. The many new tax laws that impact 2010, 2011 and beyond make taking a fresh look at your tax plans and assumptions more worthwhile than ever.

# # # # #