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CLIENT
NEWS *Letter*

Changes Abounded in 2009 to Federal Tax Law

Calendar year 2009 brought a host of changes to the federal income tax laws, and failed to bring changes to the estate tax that most practitioners expected. Gawthrop Greenwood is pleased to provide you with this discussion explaining a few of the modifications to the tax laws and suggesting some year-end tax planning that may be beneficial. This is by no means an exhaustive list, and should not be relied upon in making decisions regarding your taxes. You should seek the advice of your tax practitioner before implementing any tax planning strategies.

Stephen J. Olsen

The past year brought a host of changes to the federal income tax laws.

Federal Income Tax

Federal income tax planning could be more effective this year than at any time in the recent past. A host of deductions and credits are scheduled to be phased out over the next year or two. In addition, ordinary income tax rates and capital gains tax rates are slated to increase after 2010, decreasing the effectiveness of income deferral and the acceleration of deductions.

In doing year-end tax planning, consider some of these items:

- Review amounts being set aside in health flexible savings accounts and health savings accounts.

- Review amounts being contributed to IRA and other deferred compensation plans. If you are self-employed, consider the use of a self-employed retirement account.

- If you are age 70-1/2 or older, own IRAs, and are thinking of making a charitable gift, consider paying directly from the IRA, which can provide tax savings.

- If you believe Roth IRAs are better than traditional IRAs, consider converting traditional IRAs with assets that have depreciated over the last year into a Roth IRA. This will increase taxable income in 2009, but could create enough future tax benefits to outweigh this cost.

- If you want to convert to a Roth IRA, but are precluded from doing so due to your income, keep in mind that starting in 2010 the the existing $100,000 income test for converting a traditional IRA to a Roth IRA will no longer apply. This will allow you to subject retirement assets to taxation at current income tax rates, which may be lower than rates in the future. In addition, once the accounts are converted, future growth will not be subject to any income tax going forward as long as you meet the qualification of a tax-free distribution.

- Consider realizing losses on stocks while preserving investments. This can be done in multiple ways, but selling stock and repurchasing the same stock thirty-one days later is one simple manner.

- Determine if accelerating deductions or post poning income to decrease taxable income in 2009 is beneficial, or, conversely, if you should accelerate income into 2009 to ensure lower rates.

- Remember to determine if state income tax or state sales and use tax provides you with a better deduction.

- Regardless of which state tax deduction you take, if you purchased a new car in 2009, do not forget that the state sales or use tax paid is deductible, even if you do not itemize your deductions.

- If you are a homeowner, consider puchasing energy saving im provements to the residence before year end, such as extra in sulation or energy saving windows, and qualify for a tax credit. Additional, substantial tax credits are available for installing energy generating equipment (such as solar electric panels or solar hot water heaters) to your home.

- Remember that if you purchased your first home in the last year, you should be eligible for the first time home buyer credit. This program has been expanded for part of 2010, and now includes some existing home owners.

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Changes Abounded in 2009 to Federal Tax Law *(continued from other side)*

Federal Estate, Gift and Generation-Skipping Transfer Tax
Under current law, in 2010 there will be no estate tax and no generation-skipping transfer ("GST") tax. For decedents dying in 2010, their estates will pass to their heirs outside of those taxing regimes, regardless of the amount of their estate. In 2011, the estate and GST taxes are scheduled to return, with a $1 million exclusion amount for each (GST tax exemption is indexed for inflation).

Until quite recently, it was almost unanimously believed that Congress would not allow this to occur with the estate and GST tax. However, the year-end is upon us, and no new legislation has been passed. Various bills have been introduced in the House and Senate, some suggesting a short term patch through 2010, and others a longer-term, permanent legislation. To date, the House of Representatives passed the Permanent Estate Tax Relief for Families, Farmers and Small Businesses Bill of 2009 (H.R. 4154), permanently extending the top federal estate tax rate of 45 percent and continuing the $3.5 million estate tax exclusion. The Senate, unfortunately, is mired in a health care debate, and does not seem inclined to fully deal with the estate tax before the year end. Many practitioners still believe the Senate will not allow the repeal in 2010, and that Congress may enact retroactive legislation early next year.. This matter is made even more complex by the greatly differing views of many in Congress on the estate tax, and a potential "paygo" issue, where the House is threatening to require all bills to be cost neutral. Meaning any tax cuts would have to have offsetting tax generators. As soon as Congress acts, we will provide a summary explaining the legislation.

There are still various estate planning techniques available, and some– such as Grantor Retained Annuity Trusts and Family Limited Partnerships– which have been targeted by Congress and the President as too aggressive, may be less effective after 2009 because of the new potential legislation.

For 2009, taxpayers should consider various year end planning, including:

- Making annual exclusion gifts of $13,000 per donee ($26,000 per couple).

- Consider the use of 529 plans for children and grandchildren, and consider front loading the 529 plan with five years' worth of annual exclusion amounts. In order to avoid the potential loss of this year's $3.5 million of GST tax exemption if the law reverts to 2001 levels, you could consider the possibility of making life time gifts now to freeze the GST tax exemption. For married couples, this can be achieved without paying gift tax by making a gift to your spouse of an amount equal to the unused portion of your current $3.5 million GST tax exemption before the end of this year. The gift has to be made to a trust in which your spouse is the primary beneficiary during his or her lifetime, thus qualifying for the unlimited marital gift tax deduction, while still preserving the GST tax exemption.

- Consider the use of Qualified Personal Residence Trusts (QPRT). A discounted and leveraged gift of a residence is possible using a QPRT. After the gift to the QPRT you can continue to reside in the residence until the QPRT ends, and thereafter if you lease the property at fair market value. Because of the recent decline in property values, this may be a very attractive option, especially for vacation homes.

- Consider the use of intra-family loans. Currently, the rate of interest family members must charge each other for loans is extremely low.

- If you are charitably inclined, review whether charitable remainder trusts, charitable lead trusts, private foundations, or donor advised funds make more sense than yearly giving.

If you have questions, or would like to discuss how proper tax planning could benefit you, please contact me or one of the other attorneys at Gawthrop Greenwood, PC at 610.696.8225.

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