2010 End of Year Tax Planning Tips

Dear Clients:

Well the Fourth Quarter is here again and that means thinking about Halloween, Thanksgiving, Christmas and Hanukkah… and yearend tax planning. I hope you will find the time to sit down with your tax advisor and me to discuss opportunities which may exist for you to save money on taxes this year.

Congress and the White House are busy jockeying for position on whether -- and for how long -- to extend the Bush income tax cuts that expire at the end of this year.

So, it's time for you to get busy, too. With just a little less than three months left in 2010, you've got to make sure your own tax situation is in order.

This year it will be more challenging than usual. Myriad tax breaks expired at the end of 2009, and although Washington has done a lot of talking about extending them, they haven't done it yet. And another slew of provisions expire at the end of this year. Will they get extended? Maybe some will, and maybe some won't.

Here are a few steps you can take now that will protect you regardless of how Washington moves in the next few weeks.

Take those losses. The summer sell-off produced long-term capital losses for many investors, and there's no reason not to cash them in while you can. When you sell a stock (or mutual fund shares) that you've held for more than a year for a loss, you can deduct that loss from your capital gains. If you still have losses left over, you can take another $3,000 and use it to reduce your regular taxable income. What you cannot do is re-buy the same security within 30 days. So what? There's lots of choices out there of other securities to buy that are similar.

This year, lock in the gains, too. That's counterintuitive, but there's every reason to believe that the tax on long-term capital gains will go up next year. The top rate now is 15 percent; next year it's scheduled to go up to 20 percent, and that is where President Obama wants it. As Congress grapples with deficit woes, that rate could go even higher in the coming years. So, sell winners, pay tax at low 2010 rates and then buy what you want. If you're selling a security for a taxable gain, there's no prohibition against re-buying the same security right away.

Give shares to your low-earning children. If you want to help your adult kids transition into real life, give them winning shares of stocks or mutual funds instead of cash. Here's why: If they earn under $34,000, their long-term capital gains rate for 2010 is 0 percent. Nothing. Nada. So, instead of selling mutual fund shares to give your child cash to buy a house or car, give him the shares and let him cash them in. Note that this only works with children old enough to be emancipated from the "kiddie tax," which means they have to be 19 or older and out of school, or 24 or older if they are still in school.

Make the most of deductible spending. In 2010, there's no limit on itemized deduction, but starting in 2011, people earning more than $100,000 are likely to see their deductions limited. So any charitable contributions, local taxes or health-care costs that you can pay before December 31, you probably should.

Reverse that thinking if you're a top bracketeer. If you make over $200,000 (or $250,000 for joint filers), your tax rates could rise significantly in 2011 -- if President Obama prevails with his plan to let the Bush tax cuts expire for high earners. Then you'll wish you had saved deductions and capital losses for 2011, when they will be worth more.

Clean out your Coverdell, maybe. None of my clients have these, but if you know someone with one… After 2010, you won't be able to use funds from your Coverdell education savings accounts to pay for elementary or secondary education, according to CCH, a tax research firm. So, if that's why you've been putting money into those accounts, pay those tuition bills now. If possible, pay for spring semesters before December 31. You'll still be able to use those funds for college costs in the future, though CCH suggests you might prefer to roll over whatever is left in your Coverdell into a 529 college savings plan. They have more taxpayer-friendly benefits.

Feed your retirement funds. Year in and out, regardless of income-tax rates, it's a good deal to set aside money on a tax-deferred basis. Make sure you are on track to contribute at least as much to your 401(k) or 403(b) plan as your employer will match. If you haven't been putting in enough, talk to your company's human resources department to raise your contribution.

Buy replacement windows. A 30 percent tax credit for buying high-efficiency water heaters, boilers, heat pumps, air-conditioners, windows and doors can put as much as $1,500 in your pocket. You have to complete your transaction before December 31, 2010, when those credits expire. If you already used your credit last year, sorry -- you don't get a second one now. If you haven't, hurry up and shop.

Start spending your benefit dollars. If you have a flexible spending account for health or childcare benefits, look at how much you have left and how long you have to use the money before it evaporates. (Those accounts used to expire on December 31; now you often get until sometime in March to use them up.) Plan the dental cleaning, the new glasses and the babysitter's bonus accordingly.

Kiss your spouse. (I hope you will do this anyway!) Back in 2001, legislators gave married taxpayers as much as $1,900 in extra exemptions to make up for the so-called "marriage penalty" which taxes joint filers at higher rates than two single filers earning the same amount. That disappears after this year -- unless it's extended. There's nothing you can do about it, other than to watch that space and remind yourself that he/she is worth every penny.