



November 2009

Economists hold many different views about the current state of our economy. However, most can agree on one thing – since December 2007, the United States and much of the world has experienced the longest and deepest recession since the 1930s. News about the economy floods our media; some of which has become more hopeful in recent weeks. However, the lack of consistency in economic predictions and indicators makes it difficult to presume anything about the future.

An old English proverb wisely states that “A smooth sea never made a skillful mariner.” In the midst of this recession, many Americans have become more skillful by way of improved efficiencies in their personal finances and business practices. As we approach the end of the year, these enterprising individuals also have the opportunity to preserve assets through thoughtful tax planning. Reviewing the techniques outlined in this letter will help you begin that process.

Although very long, this letter is packed with useful information. Since some of this information may not be relevant to every reader, below is an outline to help guide you to the most pertinent sections:

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Please contact us at your earliest convenience to discuss ways we can personalize these techniques to maximize your tax savings for 2009.

2009 FEDERAL LEGISLATIVE UPDATE

Until recently, only one piece of legislation contained major tax law changes. On February 17th, The American Recovery and Reinvestment Act of 2009 became law. The underlying purpose of this bill was to provide a stimulus to the U.S. economy and to aid those most affected by the economic downturn, all at a cost of an estimated \$787 billion. The legislation contains many non-tax provisions, including increased funding for education, health care, and infrastructure.

On November 6th, the Worker, Homeownership, and Business Assistance Act of 2009 became law. Following is a synopsis of the key tax provisions contained in both bills, as well as other minor legislation passed during the year.

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LAW CHANGES PRIMARILY AFFECTING INDIVIDUALS:

- **Homebuyer Tax Credit Expanded:** Both pieces of legislation contain expansion provisions of this refundable tax credit first enacted in 2008. After December 1, 2009, a tax credit is available to first-time homebuyers *and* existing homeowners who are qualifying “long-time residents.” The credit cannot be claimed if the purchase price exceeds \$800,000. Additionally, the credit phases-out for individuals with modified AGI between \$125,000 and \$145,000 (\$225,000 and \$245,000 for joint filers). Prior to December 1, 2009, the credit is available only to first-time homebuyers, no purchase price cap exists, and lower phase-out limits apply.

For first-time homebuyers, the credit is equal to the lesser of \$8,000 (\$4,000 for married taxpayers filing separately) or 10% of the principal residence’s purchase price. For qualifying existing homeowners, the credit is limited to \$6,500 (\$3,250 for married individuals filing separately).

A taxpayer is a first-time homebuyer if he (or spouse, if married) had no present ownership interest in a principal residence in the U.S. during the 3-year period before the purchase of the home to which the credit applies. A “long-time resident” is any individual (and, if married, the individual’s spouse) who has maintained the same principal residence for any 5-consecutive year period during the 8-year period ending on the date of the purchase of a subsequent principal residence.

The credit applies to a principal residence purchased before May 1, 2010 and to purchases where a binding contract is in effect before May 1, 2010, which closes before July 1, 2010. The new law eliminates the 15 year repayment obligation for taxpayers that purchase a principal residence on or after January 1, 2009.

Additionally, the new law liberalizes many of the homebuyer rules for active service members such as extending the credit for an additional year and waiving the recapture provisions for those on qualified official extended duty.

- **Anti-Abuse Provisions for Homebuyer Tax Credit:** Various provisions have been added to prevent abuse of the homebuyer tax credit, including the following:
 - Taxpayer must be at least 18 years of age as of the date of purchase;
 - Taxpayer cannot claim the credit if he can be claimed as a dependent by another taxpayer for the tax year of purchase;
 - In order to claim the credit, an executed copy of the settlement statement must be attached to the taxpayer’s tax return; and
 - Property acquired from a person related to the person acquiring the property or the spouse of the person acquiring the property, if married, is not eligible for the credit.

- **Education Tax Credit Increased and Expanded:** The Hope Tax Credit was renamed the “American Opportunity Tax Credit.” For 2009 and 2010, the maximum credit amount increases to \$2,500 per eligible student (up from \$1,800 in 2008) and the phase-out begins with modified adjusted gross income (AGI) between \$80,000 and \$90,000 for single filers (\$160,000 and \$180,000 for joint filers). The phase-out range increases by \$30,000 for single filers and \$60,000 for joint filers from 2008, allowing more taxpayers to benefit from the credit.

The new legislation also expands the definition of qualified expenses to include course materials, allows the credit for the first four years of a student’s post-secondary education (rather than two), allows the credit to be claimed against alternative minimum tax (AMT) liability, and allows 40% of the credit to be refundable.

- **“Making Work Pay” Credit:** For 2009 and 2010, a refundable individual tax credit of 6.2 percent of earned income (not to exceed \$400 for single returns and \$800 for joint returns) was enacted. The credit is phased out at AGI in excess of \$75,000 (\$150,000 for married couples filing jointly). Most taxpayers’ withholding has been reduced to account for this credit. Others, such as self-employed individuals, may claim this credit on their tax return.
- **Economic Recovery Payment:** The new laws provides for a one-time payment of \$250 to retirees, disabled individuals and SSI recipients receiving benefits from the Social Security Administration, Railroad Retirement beneficiaries, and disabled veterans receiving benefits from the U.S. Department of Veterans’ Affairs. The one-time payment is a reduction to any allowable “Making Work Pay” credit.
- **Refundable Credit for Certain Federal and State Pensioners:** The new law provides a one-time refundable tax credit of \$250 in 2009 to certain government retirees who are not eligible for Social Security benefits. This one-time credit is also a reduction to any allowable “Making Work Pay” credit.
- **Unemployment Compensation Exclusion:** Federal income tax has temporarily been suspended on the first \$2,400 of unemployment benefits received by a recipient in 2009. The exclusion applies only to payments received from a governmental program, not those from private unemployment compensation plans. Additionally, unemployment insurance benefits have been extended through 2009, with negotiations pending to extend through 2010.
- **Subsidy for COBRA Premiums:** The new law provides a subsidy for up to nine months for workers involuntarily terminated from September 1, 2008 through December 31, 2009. The individual is required to pay 35% of the COBRA premium amount in order to receive the subsidy for 65% of the premium. In cases of high-income taxpayers, the premium subsidy may be treated as taxable income and may be required to be paid back upon filing their tax return. A high-income taxpayer is defined as those with modified AGI above \$125,000 (\$250,000 for joint filers).
- **Expanded Earned Income Tax Credit:** For 2009 and 2010, the new law lowers the income threshold allowing more taxpayers to be eligible for the credit. It also increases the credit percentage for families with three or more children.
- **Expanded Child Tax Credit:** The new law increases the eligibility for the refundable child tax credit for 2009 and 2010 by lowering the income threshold to \$3,000 (from \$8,500 in 2008).
- **Computers as an Education Expense:** Computers and computer technology, including the cost of Internet access, now qualify as education expenses in 529 education plans for tax years beginning in 2009 and 2010.
- **Tax Break for New Car Purchases:** The new law allows taxpayers to deduct state and local sales taxes paid on the purchase of a new automobile, including light trucks, SUVs, motorcycles, and motor homes. The tax break begins to phase out at earnings of \$125,000 per year (\$250,000 for joint filers). The deduction is allowed to both those who itemize their deductions as well as those claiming the standard deduction. However, the deduction cannot be taken by a taxpayer who elects to deduct state and local sales taxes in lieu of state and local income taxes. Only taxes on that portion of the purchase price not exceeding \$49,500 may be eligible for deduction.
- **Alternative Minimum Tax (AMT) Patch:** Another one year “patch” has been enacted to hold a number of taxpayers subject to AMT at bay. For 2009, AMT exemption amounts are \$46,700 for individuals and \$70,950 for joint returns. Additionally, certain personal credits may offset AMT.

- **Tax-Exempt Bond Interest not Subject to AMT:** Tax-exempt interest on private activity bonds issued in 2009 and 2010 will not be subject to alternative minimum tax.
- **Qualified Small Business Stock:** The new law increases the exclusion for gain from the sale of certain small business stock held for more than five years from 50% to 75% for stock issued after the enactment date and before 2011.
- **Decreased Required Estimated Tax Payments for 2009:** Individuals with less than \$500,000 in AGI in 2008 and more than 50% of that AGI coming from a small business are permitted to reduce their 2009 estimated tax payments. In order to avoid underpayment penalties, a taxpayer typically must pay either (1) 90% of the current year tax liability, or (2) 100% (110% if AGI exceeds \$150,000) of the prior year tax liability. The new law allows 90% of the prior year tax liability to be paid in 2009 for these qualified individuals. The difference still must be paid with the filing of the 2009 income tax return.
- **Suspension of Required Minimum Distribution Payments:** The Worker, Retiree, and Employer Recovery Act of 2008 suspends the required minimum distribution payments for 2009 typically required of defined contribution retirement plans, IRAs, and individual retirement annuities.
- **New IRA-to-Roth-IRA Conversion Rules:** Although not a part of the American Recovery and Reinvestment Act, a major change to the IRA conversion rules for 2010 may affect tax planning for many individuals.
 - 2010 will be the first year taxpayers will be able to convert funds in regular IRAs (and qualified plans) to Roth IRAs regardless of their income level. Currently, only taxpayers with modified adjusted gross income of \$100,000 or less may convert.
 - Unless a taxpayer elects otherwise, none of the gross income from the conversion is included in income in 2010; half of the income resulting from the conversion will be includible in gross income in 2011 and the other half in 2012.
 - Married taxpayers filing a separate return will be able to convert amounts in a traditional IRA into a Roth IRA (currently they are barred from doing so).
- **Changes to Energy Incentives:** The new law provides enhancements to the following energy incentives. Details regarding these credits can be found in the year-end planning checklist section.
 - Credit for improvements to energy-efficient existing homes extended;
 - Residential energy property credits enhanced;
 - Enhanced credit for plug-in electric drive vehicles.
- **Foreign Bank Account Reporting Obligations:** Each U.S. person with a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign country, must disclose that relationship if the aggregate value of the accounts exceed \$10,000 at any time during the calendar year. A form must be filed with the Department of Treasury on or before June 30th of the succeeding year. A U.S. person is defined as a (1) citizen or resident of the U.S., (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust.
- **Homesale Gain Exclusion Rules Tightened:** For sales beginning in 2009, homeowners are now required to pay taxes on gains made from the sale of a *second* home to reflect the portion of time the home was not used as a principal residence (e.g. vacation or rental property).

LAW CHANGES PRIMARILY AFFECTING BUSINESSES:

- **Extension of Bonus Depreciation:** The provision enacted in 2008, permitting businesses to immediately deduct 50% of the cost of eligible depreciable property has been extended through 2009. Eligible property includes most types of new property other than buildings.
- **Credit Acceleration Extended:** The new law extends the provision from 2008 allowing a taxpayer to elect to accelerate the recognition of a portion of its historic AMT or R&D credits in lieu of the bonus depreciation.
- **Extension of Enhanced Small Business Expensing (Section 179):** The new law also extends the enhanced section 179 limits, originally set to expire last year. Through 2009, small business taxpayers may elect to write off the cost of certain capital expenses in the year of acquisition. The expense limit is \$250,000 and begins phasing-out when capital expenditures exceed \$800,000.
- **Increased Luxury Auto Limits:** The first-year depreciation dollar limit for autos, light duty trucks or vans subject to the luxury-auto limits increases by \$8,000 for those acquired and placed in service in 2009. First-year luxury auto limits for 2009 are \$10,960 for autos and \$11,060 for light trucks or vans. The limits are \$2,960 and \$3,060, respectively, for vehicles ineligible for or electing out of bonus depreciation.
- **Expanded Loss Carryback of Net Operating Losses for Small Businesses:** Prior to the 2009 Act, net operating losses (NOLs) were allowed to be carried back to the two years before the year the loss was incurred and carried forward to each of the succeeding twenty years after the year the loss was incurred. Both major pieces of legislation made changes to these carryback provisions.

Initially, for losses incurred in 2008, the law extended the maximum NOL carryback period to five years for small businesses only, defined as gross receipts of \$15 million or less. Subsequently, the law has been further amended to provide this carryback period to all corporations, regardless of gross receipts. However, for 2009 NOLs and 2008 NOLs made under the most recent provisions, the amount of the NOL that can be carried back to the 5th tax year may not be more than 50% of the taxpayer's taxable income for that 5th preceding tax year.

- **NOL Limitation for AMT Purposes Suspended:** For tax years ending after 2002, the 90% limitation on the use of any alternative tax NOL deduction attributable to the carryback of an applicable NOL is suspended.
- **Additional FUTA Surtax Extended:** The 6.2% FUTA tax rate continues to apply through June of 2011, and the 6.0% rate applies for the remainder of calendar year 2011 and later.
- **Delay in Application of Worldwide Allocation of Interest:** The effective date of the worldwide interest allocation rules has been delayed seven years, until tax years beginning after December 31, 2017.
- **S Corporation Holding Period:** The new law provides that, for S corporation tax years beginning in 2009 and 2010, no tax is imposed on the net unrecognized built-in gain if the seventh tax year in the recognition period preceded the 2009 and 2010 tax years. Therefore, the recognition period will end at the beginning of the 2009 tax year if the S corporation election was made for the 2002 tax year and the recognition period will end at the beginning of the 2010 tax year if the S corporation election was made for the 2003 tax year.

- **Increased Penalty for Failure to File Partnership or S Corporation Returns:** Currently, the penalty for failure to file a partnership or S Corporation return is \$89 times the number of partners or shareholders for each month the failure continues (for a maximum of 12 months). New law increases this penalty to \$195 per partner or shareholder for tax years beginning after December 31, 2009.
- **Electronic Filing by Return Preparers Expanded:** Currently, the IRS is prohibited from requiring that individuals, estates, and trusts submit their tax returns electronically. However, for returns filed after December 31, 2010, new law mandates that electronic filing be required by “specified tax return preparers.” This term includes all preparers who prepare ten or more individual income tax returns in a calendar year, which includes returns for estates and trusts as well as individuals.
- **Incentives to Hire Unemployed Veterans and Disconnected Youth:** Generally, businesses are allowed to claim a work opportunity tax credit equal to 40% of the first \$6,000 of wages paid to employees of one of nine target groups. The new law expands the work opportunity tax credit to include two new targeted groups: (1) unemployed veterans; and (2) disconnected youth.
- **Delayed Recognition of Certain Cancellation of Debt Income (CODI):** For businesses that buy their own debt at a discount, a new provision allows these businesses to recognize CODI over 9 or 10 years for specified types of business debt repurchased in 2009 or 2010. Tax may be deferred on CODI for the first four or five years and recognized ratably over the following five tax years.
- **Compensation Deduction Limit:** The new law provides that each TARP recipient is subject to the \$500,000 compensation deduction limit during the period in which any obligation arising from financial assistance provided under TARP remains outstanding.
- **Changes to Energy Incentives:** The new law provides enhancements to the following energy incentives. Details regarding these credits can be found in the year-end planning checklist section.
 - Long-term extension and modification of renewable energy production tax credit;
 - Temporary election to claim the investment tax credit in lieu of the production tax credit for certain facilities that produce energy from alternative sources;
 - Business energy credit enhanced; and
 - New credit for investments in advanced energy facilities.
- **Form 8300 Reporting Requirements:** Each person engaged in a trade or business who receives more than \$10,000 in cash in one transaction or multiple related transactions, must file Form 8300. This form must be filed by the 15th day after the date the cash was received. A written statement must also be provided to be each person named on Form 8300 before January 31st of the year following the calendar year in which the cash is received.

2009 TENNESSEE LEGISLATIVE UPDATE

Recent changes and updates to Tennessee law in 2009 include:

- ❖ **Franchise and Excise Tax - Net Earnings Includes Unreasonable Rent Paid to Affiliate:** For purposes of franchise and excise tax, rent payments for use of industrial and commercial property owned by an affiliate must not exceed two percent per month of the appraised value of the property in order to be deductible for Tennessee excise tax purposes. All rent payments above this threshold must be included in net earnings.

- ❖ **Franchise and Excise Tax - Family Owned Non-corporate Entity (FONCE) Exemption Changes:** Effective July 1, 2009, new legislation removes “rent” from the definition of “passive investment income” for purposes of the FONCE exemption. Instead, only “rents from residential property or farm property” meet the passive income definition and qualify for exemption from franchise and excise tax. Consequently, industrial and commercial rental income will now be treated as non-passive income in determining whether the entity qualifies for the FONCE exemption.

Therefore, if a family-owned LLC’s or LP’s gross income is more than 1/3 from commercial or industrial rent, the entity likely will be subject to the Tennessee franchise and excise tax (unless another exception is met). These entities have the option of converting to an “obligated member entity” (OME), which is exempt from Tennessee franchise and excise tax. However, OMEs are offered no liability protection, thereby subjecting all owners of the entity to personal liability.

All entities wishing to file the OME election for 2009 were required to submit documentation by October 1, 2009. Taxpayers that converted to an OME on or before October 1, 2009, must also file an Application for Exemption form with the state by November 30, 2009. The application must include a copy of the appropriate documentation showing the OME election was filed on or before October 1, 2009.

For subsequent tax years, the exemption application must be filed on or before the first day of the taxable year for which the exemption applies.

- ❖ **Franchise and Excise Tax - Annual Exemption Application Required:** Taxpayers claiming specific statutory exemptions from franchise and excise tax must file an annual exemption application no later than the fifteenth day of the fourth month following the close of the tax year. Initial applications must be filed within 60 days of the beginning of the first tax year for which the exemption relates. A penalty of \$1,000 applies for untimely filed applications. Additionally, a disclosure of activities must also be filed annually.
- ❖ **Sale and Use Tax Electronic Filing Threshold Reduced:** Sales tax returns must be filed electronically (and payment submitted electronically) if average monthly sales and use tax liability exceeds \$1,000 during the past consecutive twelve months. This threshold was previously \$2,500.
- ❖ **Streamlined Sales Tax Legislation Delayed:** The implementation of the remaining Streamlined Sales Tax legislation has been delayed from July 1, 2009, to July 1, 2011.
- ❖ **Franchise and Excise Tax Electronic Filing Requirement Clarified:** Taxpayers must submit quarterly franchise and excise tax payments electronically if the payment exceeds \$2,500. Additionally, payments made with the return of \$10,000 or more must be made electronically.
- ❖ **Job Tax Credit Expanded:** The amount of the job tax credit increases to \$4,500 per job, regardless of the county in which the job is created. One-half of the total liability can be offset by this credit.
- ❖ **Automatic Extension Allowed for Inheritance Tax Returns:** An automatic 12-month extension is now provided for the filing of inheritance tax returns. The extension request should be attached to the return upon filing on or before the extended due date, and may either be the applicable state form or a copy of the federal extension request.

- ❖ **Business Tax Amendments:** Several changes were made to Tennessee's business tax statute, including the following:
 - Annual business tax returns and payments will now be filed with the Department of Revenue, although local governments will still handle new business tax licenses and annual renewals.
 - The personal property tax credit can offset up to 50% of the total business tax liability, and is no longer limited to the local portion of the business tax.
 - In order to deduct payments to subcontractors, general contractors must obtain detailed information including name, address, business tax license number or contractor's license number.

EXPIRING PROVISIONS AND PENDING LEGISLATION

As you approach year-end planning for 2009, it is more important than in most years to be mindful of the many expiring provisions that may not be available in the future. You may consider the tax breaks included in this list to be especially valuable this year if you expect income tax rates and long-term capital gains rates to increase in the future. As noted below, the extension of many of these provisions are currently being negotiated in Congress.

- **Individual Tax Breaks:** The following individual tax breaks are scheduled to expire at the end of 2009:
 - State and local sales tax deduction for taxpayers who itemize;
 - Standard or itemized deduction for sales tax and excise tax on motor vehicle purchases;
 - Standard deduction for real property taxes for non-itemizers;
 - Above-the-line deduction for higher education expenses;
 - Above-the-line deduction for educator expenses;
 - Subsidy for COBRA premiums;
 - Higher AMT exemption amounts;
 - Personal credits allowed to offset AMT; and
 - Nontaxable IRA transfers to eligible charities for taxpayers aged 70 ½ or older.
- **Unemployment Compensation Exclusion:** A bill has been introduced in Congress that would extend the suspension of federal income tax on the first \$2,400 of unemployment benefits received. Currently, this provision expires at the end of 2009.
- **Business Tax Breaks:** The following business tax breaks are scheduled to expire at the end of 2009:
 - Bonus depreciation;
 - Extraordinarily high \$250,000 section 179 expensing limitation;
 - Research tax credit;
 - Five-year write-off for most farm equipment; and
 - Fifteen-year write-off for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements.

- **Gift and Estate Tax Unknowns:** A move is underway in Congress to stave off the sunset of the estate tax in 2010. It is likely that the bill would repeal both the 2010 one-year termination of the estate tax and the new basis rules, increase the estate and gift tax unified credit beginning in 2010, and coordinate a reduction in the maximum tax rate.

The applicable exclusion amount increased from \$2 million to \$3.5 million for estates of decedents dying in 2009. The top rate currently remains at 45%. Barring further Congressional action, the estate tax is repealed for 2010 deaths, only to be reinstated for deaths occurring in 2011 and later with a \$1 million exemption and a top rate of 55%.

On November 7, 2009, the House of Representatives passed the “Affordable Health Care for America Act.” This bill would make massive changes, including an overhaul of the health insurance delivery system, a requirement that most people obtain health coverage or pay a penalty tax, and change a number of information reporting and compliance rules. Many tax provisions are included in the House’s version of the bill. Following are some examples of the key proposals:

- ✓ For tax years beginning after 2010, a 5.4% tax surcharge would be levied on modified adjusted gross income in excess of \$1 million for joint returns and \$500,000 for all other returns.
- ✓ For tax years beginning after 2012, tax credits would be available for businesses with 10 or fewer employees and \$20,000 or less in average wages who offer qualified health insurance coverage.
- ✓ For expenses incurred after 2010, nontaxable reimbursements from health flexible spending accounts, health reimbursement arrangements, and health savings accounts or Archer medical savings accounts would not include a medicine or drug unless it is prescribed or is insulin.

We will be sure to keep you informed on the contents of the final legislation.

YEAR-END PLANNING TECHNIQUES

Following are some fundamental tax planning techniques that are worthy of consideration.

As always, tax planning should not occur in a vacuum. It must consider each taxpayer's particular situation and planning goals, with the aim of minimizing taxes to the greatest extent possible. While most taxpayers will benefit by following the traditional deferring income and accelerating deductions approach, others with special circumstances may do better by accelerating income and deferring deductions.

Many people expect increases in tax rates (including long-term capital gains rates), which means that accelerating income and deferring deductions should be considered by most taxpayers. Without Congressional intervention, after 2010 the tax brackets above the 15% bracket will revert to their pre-2001 levels (39.6%, 36%, 31%, and 28% instead of the current rates of 35%, 33%, 28%, and 25%).

Income deferral from 2009 to 2010 may aid taxpayers in the following situations:

- Taxpayers who would otherwise qualify for certain tax breaks whose availability is limited by AGI (i.e. Education tax credits, Coverdell Education Savings Account contributions, IRA and Roth IRA contributions, sales tax deduction on new vehicle purchases).
- Retirement, unemployment, or a business slowdown that will result in the taxpayer dropping into a lower tax bracket next year.
- Next year a child will escape the kiddie tax and be in a lower bracket than his parents.

- Taxpayer expects to be divorced in 2010.
- Taxpayer expects to go from single to head-of-household status in 2010.
- Cash-basis farmers hit by drought, livestock disease or flood.

Income deferral techniques include:

- Defer interest income by investing in short-term instruments (cash-basis taxpayers).
- Convert taxable interest to tax-exempt interest.
- Pay off debts.
- Postpone the closing of a sale.
- Increase contributions to 401(k) plans, SIMPLE pension plans, etc.
- Increase contributions to health savings accounts.
- Defer receipt of year-end bonuses (that are not “constructively received”).
- Defer realizing capital gains to 2010.
- Take capital losses in 2009.
- Accelerate payment of deductible expenses.
- Use the installment method to defer taxable gain on sales.
- Delay a corporate liquidation to defer recognition of gain.
- Delay year-end billing to customers until 2010 (for cash-basis businesses).
- Consider the election to defer debt discharge income related to the reacquisition of applicable debt instruments.

Income acceleration to 2009 from 2010 may aid taxpayers in the following situations:

- Taxpayer expects to be in a higher tax bracket next year.
- Head-of-household or surviving spouse status ends after this year.
- Taxpayer plans to get married next year.
- Taxpayer expects to be eligible for one or more credits next year (e.g., the child tax credit), but not this year, that are subject to phase-out when AGI reaches specified limits.
- Taxpayer expects to start receiving Social Security benefits next year.
- Taxpayer expects to convert a traditional IRA to a Roth IRA in 2010 and elect to pay tax on the conversion in that year.
- C-Corporation expects to be subject to the 39% tax rate "bubble."

Income acceleration techniques include:

- Plan to receive bonuses prior to year-end.
- Accelerate collection of accounts receivable into 2009 (for cash-basis businesses).
- Increase pension or IRA distributions (for those over age 59-1/2).
- Sell assets that have appreciated in value.
- Redeem U.S. Savings Bonds.
- Elect to report interest on Series EE or I bonds each year as it accrues.
- Utilize certain income tax provisions that accelerate the recognition of the deferred gain imbedded in an installment sale obligation.
- Defer payment of deductible items until 2010.

In any decision to defer or accelerate income, one should take into account the time value of money. Deferring taxes can save money even though deferral produces no tax savings or costs slightly more in taxes, since it allows the taxpayer to use his or her own money a little longer, before handing it over to the government. On the other hand, accelerating income to avoid higher rates anticipated in a later tax year means paying tax earlier than necessary. Whether accelerating income makes sense depends on how much the taxpayer saves by the early payment of taxes on the accelerated income, compared to how much

he or she could earn on the money used to pay the taxes if it were invested in a different way.

For taxpayers who decide, based on all the relevant circumstances, that accelerating expenses and deferring income is the prudent strategy, there are a number of obstacles to remember. Key obstacles include:

- Passive activity limits that generally bar the use of losses and credits from those activities as offsets to actively-earned or portfolio income.
- Restrictions on the use of the installment method.
- Constructive sale rules that can prevent a short-sale or option transaction from successfully deferring gain recognition.
- A requirement that large C corporations, partnerships with a C corporation partner, and “tax shelters” use the accrual method.
- A general prohibition on the deduction of personal interest, except for qualified residence interest.
- The at-risk rules.
- The wash sale rules, which prohibit capital loss deductions when “substantially identical securities” are purchased or sold 30 days before or after the sale date.

The techniques mentioned above are only a few of the methods for deferring or accelerating income; other methods may be available depending on your specific tax situation. Please keep in mind that the strategies discussed are general techniques only and could be affected by other portions of the tax code. Therefore, before implementing any of these techniques, please contact us so that we may assess the tax consequences of your specific planning strategies.

YEAR-END PLANNING CHECKLIST

There are many potential tax-saving steps that can be taken before the end of this year. Following is a list of some of the most important actions that should be taken no later than December 31, 2009, in order to maximize tax savings:

Planning for Individuals:

Investments:

- ❑ Realize losses on stock while substantially preserving investment position by:
 - Doubling up. Buy more of the same stocks or bonds, and then sell the original holding at least 31 days later. The risk here is of further downward price movement.
 - Sell the original holding and then buy the same securities at least 31 days later.
 - Sell the original holding and buy similar securities in different companies in the same line of business. This approach trades on the prospects of the industry as a whole, rather than the particular stock held.
 - In the case of mutual fund shares, sell the original holding and buy shares in another mutual fund that uses a similar investment.
- ❑ Consider selling assets to offset capital gains and losses realized earlier in 2009. Appreciated assets could be sold to offset realized losses, while investments in loss positions could be sold to offset 2009 gains.

- ❑ Consider investing in Series E, EE, and I U.S. savings bonds. These bonds do not pay interest currently but increase in value until redemption or final maturity. Unless the taxpayer elects to be taxed currently, no tax is due on this increase in value until the bonds are disposed of, redeemed, or reach final maturity. This makes these bonds a good way to earn tax-deferred income.
- ❑ If your child is not subject to kiddie tax this year but will be in 2010, consider having him or her sell appreciated stock this year. In many cases this will result in a 5% tax on the gain, instead of 15% if the sale is postponed until next year when the gain will be taxed at the parents' rate. (The zero percent tax does not apply to children subject to kiddie tax.) If long-term capital gains rates increase in 2010, the tax savings could be even greater.
- ❑ Consider shifting income to children, even if the children are subject to the kiddie tax. Since many phase-outs are based on AGI (i.e. personal exemptions, itemized deductions, medical and miscellaneous deductions, etc.), reducing the parent's AGI by shifting income may allow them to better utilize the phase-out floors.
- ❑ Consider electing to include a child's unearned income on the parents' tax return if increasing the parent's AGI would allow them to claim a larger charitable deduction or investment interest deduction. It may also be beneficial to offset a child's capital gains with the parents' capital losses.
- ❑ Convert investment income taxable at regular rates (e.g., interest income) into qualifying dividend income.
- ❑ To avoid having losses disallowed from the wash sale rules, a seller of loss shares should instruct the fund manager not to reinvest dividends for at least 30 days.
- ❑ Review outstanding debts to ensure they remain collectible. Deductions may be available for partially or wholly worthless debt if certain conditions are met and collection efforts have been made and adequately documented.
- ❑ Review FDIC insurance coverage at each banking institution where money is held, and redistribute funds as necessary to ensure maximum FDIC coverage.

Business Activities:

- ❑ Step up the level of participation in your business activity to meet material participation standards under passive loss rules by:
 - Participating in an activity more than 500 hours during the tax year, or participating more than 100 hours if no one else does more.
 - Participating more than 500 hours in all "significant participation activities." A "significant participation activity" is one in which the taxpayer participates for more than 100 hours and in which he does not materially participate under any other rule.
- ❑ Dispose of passive activities to free up suspended losses.
- ❑ Review organization documents to be sure income allocation and distribution provisions are being followed.

Deductions:

- ❑ Apply a bunching strategy to “miscellaneous” itemized deductions, medical expenses and other itemized deductions to increase deductible amounts. Extend subscriptions to professional journals, pay union or professional dues, enroll in (and pay tuition for) job-related courses, etc., to bunch into 2009 miscellaneous itemized deductions subject to the 2%-of-AGI floor.
- ❑ If possible, accelerate or defer medical expenses so that they will exceed the 7.5% limit in at least one of two tax years.
- ❑ Prepay personal loans while leaving mortgage loans outstanding since qualified residence interest is deductible. Also, the interest rate on the personal loans is usually higher than the rate on the mortgages.
- ❑ Consider setting up a Health Savings Account (HSA) if you were covered by a high-deductible health plan at any time during 2009. High-deductible health plans (HDHPs) are defined as those with deductibles in excess of \$1,150 for individuals or \$2,300 for families. Contributions to an HSA are deductible as above-the-line AGI reductions. Eligible HSA participants must not be covered by any other plan that is not an HDHP, must not be eligible for Medicare benefits, and may not be claimed as a dependent on another person’s tax return. The deadline for making HSA contributions for 2009 is April 15, 2010.
- ❑ Review Social Security benefits carefully if you are supporting parents or other relatives receiving these benefits. Support payments must be made carefully to make sure the maximum dependency deduction is received.
- ❑ If a taxpayer furnishes more than half of the support for his parent, he can deduct the medical expenses he paid for this parent, subject to the taxpayer's overall 7.5%-of-AGI floor. To ensure that medical expenses paid for parents will be allowed, the taxpayer should be prepared to prove the amount of support provided.
- ❑ Take advantage of the above-the-line deduction for up to \$250 of unreimbursed qualified educator expenses for items such as books, supplies, computer equipment, and other equipment and supplementary materials used in the classroom.
- ❑ Take advantage of the option to deduct general sales and use taxes in 2009 as well as the standard or itemized deduction for sales and excise tax on motor vehicle purchases. Purchase any big ticket items (cars, boats, etc.) by the end of the year to make use of the options as they will not be available after 2009 unless Congress extends the provisions.
- ❑ Non-itemizers should consider paying 2010 property taxes in 2009 to maximize the benefits of the property tax deduction which expires after 2009.
- ❑ Consider deferring a debt cancellation event until 2010.
- ❑ Consider the home mortgage debt forgiveness relief, which provides taxpayers up to \$2 million of mortgage debt forgiveness on their principal residence. This applies to indebtedness discharged before January 1, 2013.
- ❑ Use credit cards to prepay expenses that can generate deductions for this year. With the exception of credit card charges made before year-end, individuals operate on the cash basis. Therefore, all other deductions must be paid by cash or check before year-end to be deductible.

- ❑ Before claiming a home office deduction, consider that any depreciation claimed for your home will reduce the amount of gain eligible for the home sale exclusion.

Charitable Contributions/Gifting:

- ❑ Make gifts taking advantage of the federal and Tennessee gift tax exclusions (see annual limits below). Remember that a gift by personal check must be deposited by the recipient in 2009 to be counted as a gift for this year. If you are giving gifts close to year end, use cashier's checks.
- ❑ Consider making 2010 charitable contributions in 2009 as speeding up the deduction may produce an overall tax savings. On the other hand, a taxpayer who expects to be in a higher bracket in 2010 should consider deferring contributions until that year.
- ❑ Obtain a contemporaneous, written receipt from charitable organizations for all gifts made. Get Form 1098-C from donee organizations to which you donated vehicles worth more than \$500. In addition, comply with substantiation requirements for certain non-cash gifts exceeding \$5,000 by obtaining a timely, qualified appraisal.
- ❑ If donating a used auto to charity before the end of 2009, consider the special rules that apply to such a donation. In the case of donated motor vehicles (as well as boats and airplanes) with a claimed value of more than \$500, the amount of a taxpayer's charitable deduction for the donation depends on how the vehicle is used by the charity.
- ❑ If you own appreciated property that you expect to further appreciate in value and that you want to continue to hold, consider using cash that you would otherwise contribute to charity to buy additional property of the same type and contribute the property you first owned to charity. Not only will you get a deduction equal to the full fair market value of the property you contribute to charity, you will have a higher basis in the newly acquired property, thus reducing the amount of gain you will recognize if you sell it.
- ❑ If you are age 70-1/2 or older, and own IRAs (or Roth IRAs), and are thinking of making a charitable gift before year-end, arrange for the gift to be made directly by the IRA trustee. Such a transfer can achieve important tax savings. This opportunity is scheduled to expire after December 31, 2009.
- ❑ Higher-bracket taxpayers should consider making year-end gifts of appreciated capital assets to low-bracket family members, who can then sell the assets next year and possibly achieve a zero percent rate through 2010. However, the kiddie tax rules could eliminate this potential tax benefit.
- ❑ Consider the use of low interest loans to family members as a means of obtaining the use of funds without incurring gift tax.
- ❑ Consider making gifts to Section 529 college savings plans on behalf of children and grandchildren. Contributions to these plans reduce the federal estate of the contributor. Account earnings are generally exempt from federal and Tennessee income tax and qualified distributions are not income to the beneficiary.
- ❑ Consider the economic benefits of gifting during your lifetime rather than upon death. The effective tax rate of lifetime gifts is reduced because the gift tax payment reduces the estate value.
- ❑ Consider making other tax-free gifts by making payments for qualified education or medical expenses directly to the providers of such services on behalf of persons to whom you wish to make gifts.

Estate Planning/Trusts:

- ❑ Consider the use of trusts to achieve goals related to safeguarding of assets, after-death transfers, and charitable giving.
- ❑ Complex trust and estate distributions made within the first 65 days of 2010 may electively be treated as paid and deductible in 2009. Fiduciaries can wait until 2010, when the 2009 tax picture will be clearer, to decide whether the payments may be more profitably imputed back to 2009 via the 65-day rule, or treated as 2010 payments.
- ❑ Consider updating wills and estate planning documents.
- ❑ Review your selection of executor and trustee, as well as guardians of minor children and other dependents.
- ❑ Consider reviewing the titling of all assets and named beneficiaries on retirement plans, annuities, and insurance policies.
- ❑ Review trust documents to ensure all relevant provisions are being followed.

Other:

- ❑ If you have income in addition to your salary, you may find that the amount of tax withheld from your salary is not enough to cover your required estimated tax payments. Consider having your withholding increased and/or making an estimated tax payment in order to mitigate penalties.
- ❑ Take steps to avoid or minimize income tax on Social Security benefits.
- ❑ Consider the AMT, which applies to both individuals and many corporations. A decision to accelerate an expense or to defer an item of income to reduce taxable income for regular tax purposes may not always save taxes because it may subject the taxpayer to the AMT.
- ❑ With AMT exemption amounts scheduled to decline considerably in 2010, consider ways of accelerating AMT income into 2009 (e.g. capital gain incentive stock option exercises in 2009 rather than 2010, accelerating tax and miscellaneous deduction payments into 2009, etc.).
- ❑ Increase the amount you set aside for 2010 in your employer's health flexible spending account if you set aside too little for this year. Do not forget you can set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.
- ❑ Make sure your name and the names of your spouse and dependents match the names reported on the respective Social Security cards. Personal exemptions, dependency deductions, and electronic filing will be denied if the names do not match the Social Security cards. Also, obtain a Social Security number for any child born or adopted during the year.

Retirement:

- ❑ Consider making a contribution to an IRA or a Roth-IRA even if an income tax deduction is not allowed for 2009. The deferral of tax on earnings that accumulate in the IRA may still create opportunities for overall tax savings. Remember that non-working spouses may, in some instances, contribute up to \$5,000 to an IRA.

- ❑ An individual whose AGI does not exceed \$100,000 for 2009 (and who is not a married individual filing a separate return for the year) should consider a roll over of funds this year from a traditional IRA to a Roth IRA under the usual 60-day rollover rules of Code Sec. 408(d)(3), or a conversion of a traditional IRA to a Roth IRA. Individuals considering whether to roll over or convert for 2009 should keep in mind that unlike the usual IRA rollover, a switch from a traditional IRA to a Roth IRA is not income tax free. Instead, it is treated as a distribution from the traditional IRA, taxable (but generally not subject to the 10% early withdrawal penalty tax) as if it had been distributed and not rolled over into another IRA. The tax implications of the rollover may be at an all time low given the decline in stock values. However, waiting until early January to roll over the funds would provide the individual the option of deferring income recognition until 2011 and 2012.
- ❑ High income taxpayers should consider converting regular IRAs and qualified plans to Roth IRAs in 2010 since the AGI limitation is being removed. However, consider opting out of the income deferral until 2011 and 2012 if you believe your tax rate will be higher than in 2010. In this situation, it may be wise to defer deductions to 2010 and accelerate income into 2009 in order to avoid having the IRA conversion taxed in a higher bracket.
- ❑ Set up a self-employed retirement plan. A self-employed person who wants to contribute to a Keogh plan for 2009 must establish that plan before the end of 2009. Since the contribution deadline is extended when the tax return filing deadline has been extended, taxpayers who temporarily lack sufficient funds or are otherwise delayed in making post-year-end contributions should request an extension of time to file their return.
- ❑ If you are age 70-1/2 or older, and took a distribution from a retirement plan or IRA earlier this year, you may be able to avoid tax on the payout by rolling it over into an eligible retirement plan before December 31, 2009.
- ❑ Consider minimum distribution requirements on IRAs. Typically, taxpayers must start taking annual required minimum distributions (RMD) from their traditional IRAs by April 1 following the year in which they attain age 70 1/2. Failure to withdraw the annual RMD could expose the taxpayer to a penalty tax equal to 50% of the excess of the amount that should have been withdrawn over the amount that actually was withdrawn. As mentioned previously, this requirement was suspended for 2009.
- ❑ For taxpayers unaware of the suspended RMD rules for 2009, who continued to receive “unnecessary” retirement plan distributions in 2009, may take advantage of an extended rollover period to reinvest these funds and reduce their AGI for 2009. The deadline for corrective action is November 30, 2009.
- ❑ For taxpayers who inherited an IRA where there are multiple beneficiaries for the IRA, consider splitting the accounts into several accounts no later than December 31, 2009. This can yield important tax benefits based on the required distributions rules.

Planning for Businesses:

- ❑ Place equipment in service before year-end to get six months' worth of depreciation deductions unless the mid-quarter convention would be triggered.
- ❑ Consider maximizing the purchase of section 179 property in 2009 by taking advantage of the \$250,000 expensing limit, which is scheduled to drop to \$134,000 in 2010. Consider making this election even if the amount cannot be currently deducted due to taxable income limitations. This preserves the taxpayer's right to carry the deduction forward to future years, rather than recovering the cost through depreciation deductions.
- ❑ In most cases, a business should try to avoid buying and placing in service more than the ceiling amount of expensing-eligible property during the year (\$800,000 for 2009), if it is possible from a business standpoint to defer additional purchases.
- ❑ Deciding to make the section 179 election should be weighed against the potential downsides, such as the recapture rules that apply if the business use of the property drops to 50% or less during the recovery period of the property.
- ❑ Consider not making the section 179 election for mortgaged property.
- ❑ Consider maximizing the purchase of qualifying property eligible for the 50% bonus depreciation, which expires at the end of 2009.
- ❑ Consider the election to deduct research expenditures rather than capitalize them.
- ❑ Remember to consider the impact of the passive activity loss limitation rules.
- ❑ An accrual basis corporation can take a deduction for its current tax year for a bonus not actually paid to its employee until the following tax year if :
 - The employee does not own more than 50% in value of the corporation's stock;
 - The bonus is properly accrued on its books before the end of the current tax year; and
 - The bonus is actually paid within the first 2-1/2 months of the following tax year.
- ❑ Review your tax basis and the structuring of loans related to investments in pass-through entities (partnerships, limited liability companies, and S-Corporations) to determine whether at-risk limitations apply that prevent the deductibility of losses.
- ❑ Take advantage of an interest deduction by paying interest on related-party loans by year-end or the loan's anniversary date.
- ❑ Make sure that all related-party loans are properly documented with loan agreements.
- ❑ Consider the effect of the Domestic Production Activities Deduction. Calculating the deduction will also highlight tax saving moves for 2010.
- ❑ If eligible for the Domestic Production Activities Deduction, consider deferring some domestic production activity income into 2010 since the deduction percentage jumps from 6% in 2009 to 9% in 2010.

- ❑ Corporations should try to time the realization of their capital losses for 2009 or 2010 to get the greatest tax benefit. If a corporation had capital gains in 2006, 2009 is the last year in which to realize capital losses to recover the tax paid on those gains.
- ❑ If you own or are an officer of a business entity, maintain documentation of all significant transactions in annual minutes of directors' or management meetings, including justification for bonuses.
- ❑ Recently, new businesses have considered flow-through entities rather than traditional C-Corporations since individual tax rates are still lower than corporate rates. Conversion to an S-Corporation from a C-Corporation has also been advantageous for certain businesses. However, new businesses must carefully consider the currently scheduled 2011 individual tax rate increases, as well as other potential tax rate changes, when determining whether a C-Corporation or flow-through entity is more attractive.
- ❑ Consider year-end compensation and bonus strategies that may help manage federal and state income taxes. Be aware of strict rules regarding the deposit of payroll taxes on the next banking day if total payroll taxes (both employee withholding and employer's FICA taxes) exceed \$100,000.
- ❑ Consider that an employer may only deduct "reasonable" compensation, which is defined by section 162 as \$1 million per year for each key employee of a publicly held corporation. This limit is now \$500,000 for employers from which one or more troubled assets are acquired under the "troubled asset relief program."
- ❑ With dividend taxes being at an all-time low, corporations facing an accumulated earnings tax or personal holding company tax should consider paying dividends to its stockholders to avoid these penalty taxes.
- ❑ A C-Corporation may claim an enhanced charitable contribution deduction equal to the lesser of (a) basis plus half of the property's appreciation; or (b) twice the property's basis, for contributions before January 1, 2010, of (a) food inventory and (b) qualified contributions of book inventory to certain public schools if donee certification requirements are met. A C-Corporation's total charitable deduction for the year may not exceed 10% of its taxable income, computed without regard to charitable deductions, dividends received, net operating losses, or capital loss carrybacks.
- ❑ For tax years beginning before 2010, a C-Corporation may claim an enhanced charitable deduction equal to the lesser of (a) basis plus half of the property's appreciation; or (b) twice the property's basis, for contributions of computer technology or equipment (software, computer or peripheral equipment, and fiber optic cable) to schools or libraries for use in the U.S. for educational purposes that is related to the donee's purpose or function. A C-Corporation's total charitable deduction for the year may not exceed 10% of its taxable income, computed without regard to charitable deductions, dividends received, net operating losses, or capital loss carrybacks.
- ❑ Tax-exempt businesses should review the new Form 990 format and new disclosure requirements to ensure they are in compliance with the new standards.
- ❑ Farmers hit by drought, livestock disease or flood may take advantage of several income-deferral opportunities created especially for their situations, such as a one year deferral of gain on certain sales, treat certain sales as an involuntary conversion, and defer the recognition of crop insurance and federal disaster payments received in 2009 until 2010.

Naturally, the strategies and items on the checklist above are not all-inclusive and do not constitute specific advice. Each situation is different and requires a thorough analysis of the facts in conjunction with complex tax law.

Credit Opportunities for Individuals and Businesses:

A number of credits available to individuals and businesses may be obtained or increased by stepping up certain expenditures before the end of 2009:

- ❑ **Homebuyer Tax Credit:** An individual may claim a credit equal to the lesser of \$8,000 (\$4,000 for married taxpayers filing separately) or 10% of the principal residence's purchase price, subject to certain limits and phase-outs. See the first section of this letter, 2009 Federal Legislation Update, for details on this credit.
- ❑ **American Opportunity Tax Credit (formerly Hope Tax Credit):** A tax credit of up to \$2,500 is available to eligible students for each of the first four years of their post-secondary education, subject to phase-outs based on AGI. Details of this credit can be found in the first section of this letter, 2009 Federal Legislation Update.
- ❑ **Non-business Energy Property and Residential Energy Efficient Property Credit:** A 30% credit is available to individuals who make qualified energy efficiency improvements to their home and incur residential energy property expenditures. The maximum credit amount is \$1,500.
- ❑ **Alternative Motor Vehicle Credit:** An individual may claim the sum of the following credits:
 - Qualified fuel cell motor vehicle credit;
 - Advance lean-burn technology motor vehicle credit;
 - Qualified alternative fuel motor vehicle credit; and
 - Qualified hybrid motor vehicle credit.

These credits phase out during different time periods, depending on the manufacturer and the quantity sold.

- ❑ **Electric Vehicle Credits:** An individual may claim the following credits for electric vehicles:
 - Plug-in electric drive vehicle credit;
 - Plug-in electric vehicle conversion credit.
- ❑ **Rehabilitation Credit.** A two-tier credit applies to the cost of rehabilitating buildings first placed in service before 1936 (10%) and certified historical structures (20%). The credit is 13% (26% for a certified historic structure) of the qualified rehabilitation expenditure for eligible buildings located in the GO Zone paid or incurred after August 27, 2005, and before January 1, 2010.
- ❑ **Business Energy Credits for Geothermal and Solar Property:** Taxpayers who acquire and place in service geothermal or solar property during 2009 may be able to claim tax credits equal to 10% and 30%, respectively.

- ❑ **Low-Income Housing Credit:** This credit is claimed annually over a 10-year period at a rate set so that over that period the credits will equal a present value of 70% of the basis of a new building that is not federally subsidized or 30% of the basis of an existing building or a federally subsidized new building. The amount of the credit for any tax year is qualified basis multiplied by an “applicable percentage” prescribed by IRS for the month in which the building is placed in service.
- ❑ **Work Opportunity Tax Credit (WOTC):** Under Code Sec. 51, employers may claim a WOTC for a percentage of first-year wages up to \$6,000 per employee for hiring workers from one of several targeted groups.
- ❑ **Differential Wage Payment Credit:** Eligible small business employers that pay differential wages (payment during active duty in the U.S. uniformed services) to qualifying employees can claim a credit equal to 20% of up to \$20,000 of differential pay to each qualifying employee during the tax year, but only for payments made before 2010.
- ❑ **Agricultural Chemicals Security Tax Credit:** For expenses paid or incurred before 2013, there is a 30% credit for qualified chemical security expenditures for the tax year for eligible agricultural businesses.
- ❑ **Electricity Production Credit:** A renewable electricity production credit is allowed for the production of electricity from qualified energy resources at qualified facilities.

FEDERAL LIMITATIONS AND RATES FOR 2009 AND 2010

Following is a list of important limitations and rates that are indexed annually for inflation.

Education Savings Options:

- **Coverdell Education Savings Account (ESA) Limit:** Taxpayers may contribute up to \$2,000 annually to a tax-exempt Coverdell Education Savings Account for an individual under age 18. For contributors who are individuals, the maximum contribution is reduced ratably for modified adjusted gross income (AGI) between \$190,000 and \$220,000 for joint filers, and between \$95,000 and \$110,000 for others.
- **American Opportunity Tax Credit (formerly Hope Tax Credit):** For 2009 and 2010, the American Opportunity Tax Credit (sometimes referred to as the modified Hope Credit) phases out ratably for taxpayers with modified AGI of \$80,000 to \$90,000 (\$160,000 to \$180,000 for a joint return).

For 2009 and 2010, the American Opportunity Tax Credit will be 100% of up to \$2,000 of qualified tuition and related expenses plus 25% of those expenses between \$2,000 and \$4,000, for a total maximum credit of \$2,500 per eligible student (up from \$1,800 in 2008).

The federal legislative updates section expands on changes to the American Opportunity Tax Credit, making it more attractive to many taxpayers.

- **Interest Exclusion for Higher Education:** The interest on U.S. savings bonds redeemed to pay qualified higher education expenses may be tax-free. The phase-out for 2010 will begin at modified AGI above \$70,100 (\$105,100 on a joint return). For 2009, the corresponding figures are \$69,950 and \$104,900. This applies to Series EE and I bonds issued after 1989.

- **Lifetime Learning Tax Credit:** The Lifetime Learning Credit for 2009 and 2010 remains at \$2,000 per family for every additional year of college or graduate school. The credit continues to be phased out at modified AGI between \$50,000 and \$60,000 (\$100,000 and \$120,000 for joint filers). The Lifetime Learning Credit is calculated on a per family (per tax return) basis, whereas the American Opportunity Tax Credit is calculated on a per student basis.

Collectively, the American Opportunity Tax Credit and the Lifetime Learning Tax Credit are referred to as the “Higher Education Credit”. Both credits may not be claimed for the same student in the same tax year.

Retirement Savings Plans:

- **Defined Pension Plan Benefits:** The limitation on the annual benefit under a defined benefit plan remains unchanged at \$195,000 for 2010.
- **Elective Deferrals:** The limit on the exclusion for elective deferrals (which applies to 401(k) plans, 403(b) annuities, and salary reduction SEPs) remains unchanged at \$16,500 for 2010. Catch-up contributions for individuals aged 50 or over increases to \$5,500 (except for 401(k)(11) plans and SIMPLE plans, for which the limit remains at \$2,500).
- **IRA Contribution Limit:** The annual limit for contributions to traditional and Roth IRAs is \$5,000 for 2009 and 2010, with a \$1,000 catch-up contribution maximum for taxpayers aged 50 and older.

The allowable deductible contribution of a traditional IRA will be phased-out ratably for 2010 for MAGI as follows:

- Married filing jointly: \$89,000 - \$109,000 (same as for 2009);
- Single and head of household: \$56,000 - \$66,000 (\$55,000 - \$65,000 for 2009);
- Married filing separately: \$0 - \$10,000 (same as for 2009); and
- Married taxpayer who is not an active participant but whose spouse is an active participant: \$167,000 - \$177,000 (\$166,000 - \$176,000 for 2009).

The maximum annual contribution that can be made to a Roth IRA is phased-out ratably for 2010 for MAGI as follows:

- Married filing jointly: \$167,000 - \$177,000 (\$166,000 - \$176,000 for 2009);
- Single and head of household: \$105,000 - \$120,000 (same as for 2009); and
- Married filing separately: \$0 - \$10,000 (same as for 2009).

- **Retirement Plan Contribution Limit:** The maximum amount that can be contributed to a participant’s defined contribution account(s) by the employer and the employee combined remains at \$49,000 in 2010. The maximum compensation limit for the calculation of employer contributions to qualified plans also remains unchanged at \$245,000.
- **SEP Contribution Limit:** The annual limit on the amount an employer can contribute to a Simplified Employee Pension (SEP) for 2009 and 2010 is the lesser of 25% of compensation or \$49,000.
- **SIMPLE Deferrals:** The maximum amount of compensation an employee may elect to defer for a SIMPLE plan remains at \$11,500 for 2010. Catch-up contributions for individuals aged 50 or over remain at \$2,500.

Other Key Limitations and Rates:

- **Health Savings Accounts:** For calendar year 2010, the limitation on deductions for an individual with self-only coverage under a high deductible health plan is \$3,050. For an individual with family coverage under a high deductible health plan, the limitation is \$6,150. The corresponding numbers for 2009 are \$3,000 for individuals and \$5,950 for a family.
- **Kiddie Tax:** For 2010, the amount of a child's investment income that is exempt from tax under the kiddie tax rules will be \$1,900 (same as for 2009). A parent will be able to elect to include a child's income on the parent's return for 2010 if the child's income is more than \$950 and less than \$9,500 (same as for 2009).
- **Gift Tax Annual Exclusion:** The annual gift tax exclusion for federal and Tennessee (Class A donees) tax purposes remains at \$13,000 for 2009 and 2010. The Tennessee exclusion amount remains at \$3,000 for Class B donees for 2009 and 2010. Class A donees include husbands, wives, sons, daughters, lineal ancestors, lineal descendants, brothers, sisters, sons-in-law, daughters-in-law, or stepchildren. If a person has no children or grandchildren, a niece or nephew will be considered a Class A donee. Class B donees consist of all other recipients.
- **Section 179 Expensing:** Absent further legislation, the amount that may be expensed under Code Section 179 in 2010 will be \$134,000 (down from \$250,000 in 2009). For 2010, the expensing limit will be reduced when more than \$530,000 of eligible property is placed in service (down from \$800,000 in 2009).
- **Simplified Per Diem Business Rates:** The IRS has issued "high-low" simplified per-diem rates for post-September 30, 2009 travel. Under the optional high-low method for post-September 30, 2009 travel, the high-cost-area per diem is \$258 (\$2 more than the previous rate), consisting of \$193 for lodging and \$65 for meals and entertainment. The per-diem for all other localities is \$163 (\$5 more than the previous rate), consisting of \$111 for lodging and \$52 for meals and entertainment.
- **Business Standard Mileage Rate:** The optional mileage allowance for owned or leased autos decreased from 58.5 cents to 55 cents per mile for business travel after December 31, 2008. The rate for medical travel and qualified moving travel is 24 cents per mile for 2009. The charitable mileage rate remains at 14 cents per mile and is a statutory rate that is not adjusted for inflation. The mileage rates for 2010 have not yet been released.
- **Social Security Wage Base:** The 2010 wage base will remain unchanged at \$106,800. This will be the first year without a cost-of-living adjustment since they went into effect in 1975.
- **Earned Income Tax Credit:** In 2010, the maximum amount of earned income on which the earned income tax credit will be computed is \$5,980 for taxpayers with no qualifying children, \$8,970 for taxpayers with one qualifying child, and \$12,590 for taxpayers with two or more qualifying children. These amounts are up from \$5,970, \$8,950, and \$12,570 for 2009, respectively. The credit is calculated using IRS tables, and begins phasing-out at AGI of \$12,490 for joint filers with no qualifying children (\$7,480 for others with no qualifying children), and at \$21,460 for joint filers with one or more qualifying children (\$16,450 for others with one or more qualifying children.) These amounts are up from \$12,470, \$7,570, \$21,420, and \$16,420, respectively for 2009.

- **Standard Deduction and Personal Exemption:** The standard deduction will remain unchanged at \$11,400 in 2010 for joint filers and surviving spouses, and \$5,700 for single and separate filers. The amount for head of household filers increases to \$8,400 (up from \$8,350 in 2009). The personal exemption will also remain unchanged at \$3,650 for 2010. For tax years beginning after 2009, the rules phasing out personal exemptions of higher income taxpayers no longer apply. However, Congress may choose to restore these limitations in an effort to raise revenue.
- **Itemized Deductions:** The allowable amount of itemized deductions will be reduced if AGI in 2009 is more than \$166,800 for all returns other than married filing separately and \$83,400 for married filing separately returns. In 2009, a taxpayer will lose only 1/3 of the amount he would otherwise lose under the regular phase-out computation. For tax years beginning after 2009, the rules phasing out itemized deductions no longer apply, unless reinstated by Congress.
- **The Consumer Price Index:** CPI-U provides a good measure of the average change in prices over a period of time for a representative basket of goods and services. October 2009 data shows that the CPI-U decreased 1.3% from September 2008 to September 2009, although it rose 0.2% from August to September, 2009.

To comply with the requirements of IRS Circular 230, please be advised that, unless otherwise stated by the sender, any tax advice contained in this letter is not intended or written to be used, and cannot be used, by the recipient to avoid any federal tax penalty that may be imposed on the recipient, or to promote, market or recommend to another any referenced entity, investment plan or arrangement.

As you know, tax planning is only effective if performed before the transaction is concluded. For this reason, please seek advice in advance if you are contemplating a transaction that has economic or tax significance.

We look forward to assisting you with the implementation of any of the strategies described above. Please contact us as soon as possible if we can be of assistance. Also, please take the time to explore our newly renovated website at www.burkhartcpa.com. A complete listing of our services can be found there, in addition to an expansive amount of resources, tools, and links to better serve you.

We wish you and your family a blessed and joyful holiday season.

Burkhart & Company, P.C.