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TAX AND BUSINESS ADVISOR

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TAX AND BUSINESS Alert™

November 2010

Year-end Tax Planning

There is still time to lower your 2010 tax bill, contribute to your tax-advantaged retirement accounts, and do some tax planning for next year. Following are a few ideas to get you started prior to year-end. Please contact us for additional tax-saving ideas or guidance on tax-related questions.

Contribute to Your IRA. You can contribute up to $5,000 ($6,000 if you are age 50 or older by year-end) to your IRA in 2010 if certain conditions are met. For married couples, the combined contribution limits are $10,000 ($5,000 each) and $12,000 ($6,000 each if both are age 50 by year-end) when a joint return is filed, provided one or both spouses had at least that much earned income. These limits apply to the cumulative contributions to traditional and Roth IRAs. In addition, contributions to traditional IRAs may be tax deductible, subject to specific conditions and limitations.

Contribute to Your Employer-Sponsored Retirement Plan. The 2010 annual deferral limit for qualified retirement plans is $16,500. If you are at least age 50 by year-end, you can contribute an additional $5,500 to 401(k), 403(b), and 457 plans. These contributions normally decrease your taxable income and the income taxes thereon.


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Capital Gains. It may be a good time to consider selling capital assets (e.g., common stock) with a low cost basis. The maximum capital gains tax rate in 2010 is 15% for gains from the sale of qualifying assets held more than one year. In fact, taxpayers in the 10% and 15% ordinary tax brackets can do even better by taking advantage of the 0% capital gains rate in 2010. In addition, qualifying dividends received during 2010 generally will be taxed at the 0% or 15% capital gains rates.

Energy Credit. If you have not taken advantage of the Nonbusiness Energy Property Credit available in 2009 and 2010, it is a great way to cut energy costs and save up to $1,500 (for both years combined) in income taxes by making energy efficiency improvements to your principal residence. Basically, if you install energy-efficient insulation, windows, doors, roofs, heat pumps, hot water heaters or boilers, or advanced main air circulating fans to your home before year-end, you may be entitled to a tax credit of 30% of the purchase price, up to a maximum credit of $1,500.

529 Plans—Saving for College

Many parents and grandparents are using 529 Plans to fund their children's and grandchildren's education. However, 529 Plans are somewhat confusing because they are subject to Internal Revenue Code qualification requirements, but are operated by the various states or educational institutions under varying policies defined by them. 529 Plans established by the states come in two basic formats: (a) prepaid tuition plans and (b) savings plans. (Eligible educational institutions can only establish prepaid tuition plans; these institutions cannot set up savings plans.) Every state offers at least one 529 Plan.

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A prepaid tuition plan is best thought of as a way to lock in the price of covered educational services at today's prices, thus insuring against college cost inflation. The tax benefits are a nice bonus. In contrast, a savings plan is best thought of as a tax-advantaged way to build up a college fund. Savings plans do not lock in the cost of covered educational services. The federal tax advantages for both types of plans are identical. Each type of plan generally allows both one-time (lump sum) and periodic contributions. Since each state plan is unique, each one must be analyzed in terms of the student's needs.

Many factors should be considered before opening a 529 Plan account. For many individuals, especially those whose children or grandchildren are years away from college, the savings plans generally will be the better choice. However, the volatility of the stock market, including years of negative returns, has renewed interest in prepaid tuition programs. Prepaid plans might be appropriate in certain circumstances, particularly for those with low risk tolerance or those who want to be guaranteed a certain amount of education credits or units. Whichever route is taken, it is important to review all of the program details, including investment options, fees, and state income tax consequences.

When a state income tax applies, individuals typically should look at their own state program first, as the state income tax consequences might make it more favorable than others. However, many individuals may find that out-of-state programs better meet their needs and objectives. Some families choose to open both a prepaid plan for the cost certainty and a savings plan for the growth potential.

Prepaid tuition plans allow individuals (generally parents) to prepay the education costs of a designated beneficiary (generally their child) at specified institutions and thereby lock in the price. The prepayments are invested by the 529 Plan. In effect, the investment return is guaranteed to keep pace with inflation in the cost of the covered educational services—nothing more; nothing less. Even if the plan's conservative investments post inadequate returns, there is no obligation to make further payments. However, if the 529 Plan earns more than enough to finance the cost of the covered educational services, the plan gets to keep the excess. In either case, once college time arrives, the covered costs of the designated beneficiary will be paid for by the 529 Plan.

Unlike prepaid tuition plans, 529 savings plans make no promises that contributions will cover a given amount of future college education. As their name implies, savings plans simply provide tax-favored savings accounts for higher education expenses.

The bad news is that savings plans are not a surefire hedge against college cost inflation. The good news is that these plans allow upside potential. If the savings plan's investment return exceeds the rate of inflation for college costs, less money is needed to fund the account. Basically, the account owner decides how much to contribute to the savings plan, chooses among the plan's investment options, and then monitors performance. At college time, the

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Gambling Winnings and Losses

If you did some gambling this year, you should be aware of the applicable federal income tax rules. You generally must report 100% of your gross gambling winnings as income. They are subject to your regular federal income tax rate, which can be as high as 35% for 2010. You can write off your wagering losses as an itemized deduction. However, your losses cannot exceed your winnings for the year. Any excess losses are nondeductible and cannot be carried over to future years.

If you qualify as a professional gambler, your gross winnings and wagering losses are reported similar to any other business. However, your deductible gambling losses are still limited to your winnings. Any excess losses are nondeductible and cannot be carried over to future years. In addition, you may also be able to deduct travel expenses and other out-of-pocket costs of being a professional gambler.

In either case, you must adequately document your gambling losses to keep the IRS happy. The government says you must compile the following information in a log or similar record: (a) the date and type of specific wager or wagering activity, (b) the name and address or location of the gambling establishment, (c) the names of other persons (if any) present with you at the gambling establishment, and (d) the amount won or lost.


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For example, the IRS says you can document income and losses from wagering on table games by recording the number of the table that you played and by keeping statements showing casino credit that was issued to you. For lotteries, your wins and losses can be documented by winning statements and unredeemed tickets. If you play the slot machines, you can document your winnings and losses by keeping a chart or table summarizing the amount you started play with at each casino visit and the amount cashed out at the end of the day.

Last, but not least, be aware that amounts you win may have to be reported to you by the gambling establishment on IRS Form W-2G (Certain Gambling Winnings). In some cases, federal income tax may have to be withheld. Any time a Form W-2G is issued to you, the IRS gets a copy. So, the government will expect to see the winnings show up on your tax return.

Please call us if you have questions or want more information on the tax rules for gambling winnings and losses.

529 Plans—Saving for College

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account is drawn down to pay some or all of the designated beneficiary's eligible expenses.

When determining the impact 529 Plans have on a student's financial aid offer, it is important to recognize that how the 529 Plan is owned (titled) can impact the financial aid computations in two ways. First, it may be an asset that can be assessed in the financial aid computation. Second, withdrawals from the 529 Plan may be treated as a resource that has a direct impact on the student's financial need (as an outside scholarship would).

Qualified distributions from state-sponsored 529 Plans and institutional programs are completely tax-free. Qualified distributions are distributions for qualified higher education expenses, including tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible educational institution. A beneficiary with special needs can also include the expenses of special needs services as qualified expenses.

Finally, 529 Plans may be particularly attractive to higher income parents and grandparents because there are no AGI-based limitations on who can contribute to these plans. In addition, the federal income and estate tax aspects generally are favorable with 529 Plans.

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Maximizing Tax Savings from Outright Charitable Gifts

A taxpayer can use either cash or property to make a charitable gift. That choice can affect the taxpayer's overall tax consequences resulting from the gift. For example, a charitably inclined taxpayer may derive greater tax benefits from gifting property to charity rather than selling the property and gifting the proceeds. In addition, consideration should be given to gifting property with unrealized appreciation to maximize the economic benefit from disposing of the property.

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Cash contributions are deductible in the year paid. A contribution generally is considered made at the time of delivery. Thus, contributions paid by check are considered made on the date of delivery or mailing (assuming the check subsequently clears in due course).

Contributions charged to a bank credit card are deductible in the year the charge is incurred, even though paid in a later year. However, interest paid on the credit card balance is not considered a charitable contribution. Charitable contributions made by credit card may be useful for a taxpayer who anticipates a greater benefit from the contribution in the current year, yet needs to defer payment until the next year.

Promissory notes given to charity generally do not constitute a charitable contribution until paid.

Transferring cash is the simplest way to make a tax-deductible donation. Unlike property, the value of a cash donation is not subject to IRS challenge. Costs associated with transferring title to property are avoided. Also, property donations by individuals may be more limited under the percentage-of-AGI limitations than cash donations. Finally, cash is generally a suitable gift for any recipient. Property donations may not always be exactly what the recipient organization needs. In fact, some property donations may cause the donee to incur costs trying to sell them or adapt them to a specific use.

The price for simplicity is giving up cash, which is not possible for all donors. A donor may prefer to donate property that is not producing current income, since he or she suffers no loss of income. A property donation may also be attractive to an owner of illiquid property or low tax basis property.

Please contact us if you have questions concerning charitable deductions and for additional tax-saving guidance.

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