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Tax & Financial Newsletter

This ***Tax and Financial Newsletter*** has three parts. First, a status report of the major individual tax changes that will be effective for 2011 if new legislation is not enacted; and what new legislation is being considered for 2011 taxes. The second part is an update on the Small Business Jobs Act of 2010 that passed late in the third quarter. The ***Newsletter*** concludes with 21 additional ***Tax Tips!*** to consider before the year-end, and tax ideas to implement for 2011. The ***Tax Tips!*** are basic strategies and, of course, numerous others exist depending upon one's circumstances.

MAJOR PROVISIONS OF INDIVIDUAL TAXES FOR 2011 AS OF LATE 2010

As of mid November 2010 the individual federal tax brackets (i.e., the rate at which your last dollar of income is taxed) increase from 2010 to 2011 for married filing jointly as follows:

2010	2011	Taxable Income
35%	39.6%	starting at $373,650
33%	36%	starting at $209,250
28%	31%	starting at $137,300
25%	28%	starting at $68,000
15%	15%	starting at $16,750
10%	15%	on the first $16,749

The 2011 maximum tax on long-term capital gains climbs to 20% from 15%. Corporate dividends that were taxed at a maximum rate of 15% will bump to the taxpayer's ordinary rate in 2011 as per above. More taxpayers will be subject to the alternative minimum tax ("AMT") due to a small exemption amount. The child tax credit will be cut in half to $500 next year. The estate tax top rate is heading to 55% with a $1,000,000 asset exemption starting in 2011.

However, our elected officials appear to all be in agreement to pass legislation to curtail some of the above increases. They agree upon: (1) corporate dividends will be taxed at a maximum of 20%; (2) increasing the estate exemption to $3.5 million, which was the amount that was in effect in 2009; and (3) a more generous AMT exemption including one for 2010. Right now it does not appear our legislatures are in agreement on anything else for 2011 taxes. But, they did recently pass some other tax breaks.

THE SMALL BUSINESS JOBS ACT OF 2010 (THE ACT)

The President and Congress passed The Act on September 27, 2010. Its goal is to attempt to ease credit lending, including about $12 billion in tax cuts. Some of the main provisions are:

The Act provides an election to expense $250,000 in 2010 or 2011 of "qualified real property." Qualified real property means certain leasehold improvement property, certain restaurant property, and qualified retail improvement property that is depreciable real property purchased for use in the active conduct of a trade or business. Typically this type of property must be depreciated over several years and does not qualify for the Sec. 179 election. Thus, it is a very good new tax break.

Although bonus depreciation was originally not in effect for 2010, it was revived for 2010. Taxpayers can claim the 50% bonus depreciation allowance if the following requirements are met: (1) the original use of the property must begin with the taxpayer after

December 31, 2007, and before January 1, 2011; and (2) the property must be acquired by the taxpayer in 2008, 2009, or 2010. The bonus depreciation, to a lesser extent, also applies to automobiles, trucks, and vans used in a trade or business.

The Act increases the Section 179 expensing limitations to $500,000 for 2010 and 2011. The limitation for these taxable years starts phasing out when new property purchases exceed $2,000,000. Currently for 2012, the Section 179 amount is $25,000, with a phase out beginning at $200,000 worth of property. But, expect Section 179 to increase for 2012 and thereafter.

For taxable years beginning in 2010, the amount of start-up expenditures that a taxpayer can elect to deduct (as opposed to writing off over 60 months) increases from $5,000 to $10,000. The Act has also increased the deduction phase-out threshold from $50,000 to $60,000.

The Act provides relief for 2010 for the built-in gains tax for S corporations if the S election was made over 7 years ago. For 2011, the Act shortens this period to 5 years. An example: if a corporation converted from C to S on January 1, 2006, it can sell its built-in gain assets (assets more valuable than they cost when the S election was made) in 2011 without tax at the corporate level. Had the Act not passed, the company would have had to wait until 2016 to sell its built-in gain assets without corporate-level taxes.

The Act creates a special rule for 2010 that allows a deduction for health insurance costs of self-employed individuals to be taken into account in determining net earnings from self-employment. Thus, health insurance for many self-employed deceases by approximately 15% and 3% for higher earning self-employed business.

The Act removes cell phones and similar telecommunications equipment from the definition of listed property. As a result, the heightened substantiation requirements and special depreciation rules that apply to listed property do not apply to cell phones.

Two other tax acts passed in 2010 also. See our website, **Paulhburgess.com** for tax details on the "Hire Act" and the "Health Care Act."

CHECKLIST OF *TAX TIPS!* FOR THE REST OF 2010 & 2011

√ A good method for reducing taxes generally has been delay paying taxes. A typical planning strategy for a cash basis taxpayer was to pay expenses in December that could be paid in January and to defer December income to January. However, it appears for 2011 that tax brackets will be about 3% to 5% more. Thus, if you have the opportunity to include income in 2010 versus 2011, perhaps report it in 2010; and if you can pay expenses in 2011 as opposed to 2010, consider that.

√ It could also be wise to sell appreciated assets and other capital assets by the end of the year before the 20% long term capital gains rate goes into effect. For example, harvest your gains in the stock market this year.

√ Investing in municipal bonds that are exempt from federal taxes (and sometimes state taxes) is a solid strategy for reducing taxes. With rising tax rates, investing in municipal bonds is more attractive. Perhaps sell appreciated stock before year end and pay the maximum long term gain rate of 15% and then invest those proceeds in municipal bonds.

√ If you have an opportunity to take dividends from a C corporation in 2010 as opposed to later, consider doing so to take advantage of the 15% maximum tax. It does appear legislation will pass whereby C corporation dividends will be taxed at only 20% for 2011 as opposed to ordinary income rates. But, that legislation has not passed as of mid November 2010.

√ Other potential ways to report more income in 2010 and less in subsequent years are:

(1) Converting a traditional IRA to a Roth IRA;

(2) Electing out of the installment method for reporting gains;

(3) Taking distributions from pass through businesses that are in excess of your tax basis;

(4) Electing slower depreciation methods, foregoing Section 179 expensing, or elect out of bonus depreciation.

If you expect your tax bracket to be the same or lower in 2011, then many of the conventional tax strategies listed below may apply while others are good ***Tax Tips!*** no matter what direction your tax bracket is heading.

√ Pay in late December 2010 your state estimated tax payment(s) that are due January 15, 2011; consider paying in late December 2010 any anticipated state taxes due in April 2011 for tax year 2010. This strategy is excellent when a taxpayer has a one-time large gain and the state taxes are due in April of the following year. By paying in December the large tax deduction for state taxes is in the same year as the large gain. The result is smoothing out taxable income which generally reduces taxes.

√ Avoid underpayment of estimated tax payment penalties by increasing your withholdings from your December 2010 paychecks.

√ For assets used more than 50% for business, but typically less than 100%, consider purchasing the asset at the very end of the year and using it 100% for business for the remaining portion of the year to take advantage of a higher §179 expense election business percentage.

√ Dispose of your interests in those flow-through entities in which you have "suspended" loss carryforwards.

√ Make sure you have tax basis in all your partnerships, LLCs, and S corporations to deduct any losses. Increasing your tax basis can be accomplished by several methods.

√ Step up your level of participation in partnerships, S corporations, or LLCs to qualify as an "active participant" for flow-through entities reporting losses.

√ Maximize 401(k) contributions before year-end and take advantage of employer matching contributions.

√ Set up pension plans before year-end and fund those plans. In many cases if a plan is "set up" by December 31, you can contribute to the plan as late as October 15, 2011 for a 2010 tax deduction.

√ Contribute to your favorite charity; consider gifting appreciated property to a charitable organization for a deduction equal to its fair market value. Clean out your home by donating non-cash charitable contributions to Goodwill, etc. The donated goods must be in good condition.

√ If you are single and maintain a separate household for your parents including in a nursing home or assisted living center, and provide more than one-half their support, you may qualify to file head of household.

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√ Generate a 2010 Oklahoma tax deduction with by funding an Oklahoma §529 plan before year end and then use those funds to pay January 2011 tuition bills.

√ Pay close attention to your state tax return and make sure you are claiming all the state tax benefits. The Oklahoma capital gain exclusion is an excellent tax saving tool. If you have appreciated Oklahoma real property or own stock, partnership interest or LLC membership interests in companies that are located primarily in Oklahoma, the capital gain under many circumstances can be totally excluded from Oklahoma taxation.

√ Consider funding education for your children or grandchildren through the Oklahoma §529 plan. Up to a $10,000 ($20,000 if married filing joint) Oklahoma income deduction is available (you can contribute more though) and the investments grow tax free if ultimately used for college and the withdrawals are not subject to tax. See www.ok4savings.org for the website.

√ If you have tax deferred retirement accounts and personal investments and the investments in the two accounts are capital gain type items (growth stocks) and ordinary income generators (bonds, money markets, etc.), it may be best for the ordinary income generators to be in the pension plans and hold the growth stocks personally.

√ It is especially important to start thinking about estate planning. Perhaps the easiest estate planning strategy is to make gifts before year-end because the first $13,000 ($26,000 for married couples) to each donee is excluded from gift tax considerations. These exclusions can save both gift taxes and family income taxes. Estate tax can also be saved because the gift and its appreciation aren't included in the donor's estate.

√ Consider making energy saving improvements to your residence, such as new insulation, exterior doors and windows, heat pumps, furnaces, and central air to qualify for up to a $1,500 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.

√ If you own a business, perhaps the best method for anticipating and reducing taxes, as well as controlling expenses and knowing current revenues, is to have monthly or quarterly accountings prepared during the year instead of an annual accounting at year-end. This allows you to spot management and tax issues with time to respond. See **Paulhburgess.com** for the 10 concepts for small business accountings ☺

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