

YEAR-END TAX PLANNING

**MP&S TAX ALERT
DECEMBER 2010**

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INTRODUCTION

Companies and individuals alike seek to minimize their tax liability while still complying with applicable tax laws and regulations. Year-end tax planning can help achieve these goals and facilitate the filing of next year's tax returns.

With a few exceptions, tax-reduction strategies have to be implemented by Dec. 31 in order to affect your tax liability for the current year (assuming you're a calendar-year taxpayer). This year — with the legislative uncertainty about 2011 tax rates as well as the availability of many tax breaks for 2010 and 2011 — tax planning is made even more challenging. We encourage you to schedule a year-end tax planning meeting with a Marks Paneth & Shron LLP (MP&S) tax advisor. This alert along with our 2010-2011 Tax Planning Guide, which is now available online on our website, can provide a framework for your discussion.

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LEGISLATIVE UNCERTAINTY

LEGISLATIVE UNCERTAINTY MAKES YEAR-END TAX PLANNING A CHALLENGE: WHAT'S SO UNCERTAIN?

Congress recessed in late September without addressing the income and capital gains tax rate increases scheduled for 2011, the return of the federal estate tax, education tax incentives, and a large number of expired and expiring tax "extenders" (i.e., numerous temporary tax benefits and incentives that were originally enacted with expiration dates that have subsequently been extended). Before recessing, they did pass legislation extending and expanding a few important business tax breaks (namely 50% bonus depreciation and higher Section 179 expensing limits), but there are many expired tax breaks that they haven't yet addressed, such as the alternative minimum tax (AMT) "patch" (discussed below) and the deduction for state and local sales tax.

Given that neither the House nor the Senate is scheduled to return until Nov. 15 (after the midterm election) and that both chambers will be recessing again the following week for Thanksgiving, there's a good chance that meaningful tax legislation will not be passed until at least December, or possibly into the new year.

The uncertainty as to whether tax rates will indeed increase in 2011 is particularly problematic because many strategies depend on knowing whether you'll likely be subject to taxes at the same or a higher or lower rate the next year. It is, of course, also difficult to implement year-end strategies when some tax breaks for the current year are still up in the air.

As was widely expected, the midterm election resulted in the Republicans recapturing control of the House and significantly narrowing their minority position in the Senate. The Republicans have insisted on extending all the Bush-era tax cuts, which expire at the end of 2010, including those for the wealthiest Americans. President Obama, on the other hand, appears to remain firmly opposed to a permanent extension for high-income taxpayers (whose income exceeds \$200,000 for single individuals and \$250,000 for married couples). While it is too early to tell with any certainty, there is the possibility that the two sides may agree on a temporary extension of 1-2 years for the full Bush-era tax cuts. This will bear watching in the weeks ahead.

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TIMING AND TAX RATES

Generally, you can save taxes by timing:

- Income so it's received in years when you'll be subject to *lower* rates, and
- Deductions so they're paid in years when you'll be subject to *higher* rates (making the deductions more valuable).

If you'll be subject to the *same* rate, it's generally best to accelerate deductions into the current year and defer income to the next year, because this will defer tax. In 2010, however, this could be a costly strategy for many taxpayers because of tax law uncertainty.

If Congress does nothing, 2011 ordinary income tax rates will be higher for everyone except those in the 15% tax bracket:

Individual Income Tax Rates	
2010	2011
10%	15%
15%	15%
25%	28%
28%	31%
33%	36%
35%	39.6%

Congress seems to be in agreement that the 2010 rates should be extended for at least one more year for the lower and middle brackets. But there has been much debate over whether they should be extended for the top two brackets, and it's difficult to predict what will happen.

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TIMING AND TAX RATES

So, where possible, consider waiting to see what Congress does before making timing-related decisions about such actions as:

- Taking bonuses,
- Recognizing consulting or other self-employment income,
- Taking retirement plan distributions (if not required),
- Paying 2010 state and local income and property tax bills that aren't due until 2011, and
- Making charitable contributions.

If Congress doesn't extend the 2010 rates, you'll likely be better off accelerating income into 2010 and deferring deductions to 2011. However, you'll also need to carefully consider the AMT.

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THE AMT

Because tax is calculated differently under the AMT, certain income items and deductions can trigger it. So before accelerating or deferring income or deductions, consider the AMT ramifications both this year and next. Unfortunately, right now this is difficult because of uncertainty about whether an AMT patch will be extended to 2010 and/or 2011.

The AMT system isn't automatically adjusted for inflation. This means that, if Congress doesn't pass legislation to increase the exemption and phase-out ranges (the patch), they'll be smaller for 2010 than they were for 2009 — potentially making many more people subject to the AMT:

	2009	2010
AMT Exemption		
Single or head of household	\$46,700	\$33,750
Married filing jointly or surviving spouse	\$70,950	\$45,000
Married filing separately	\$35,475	\$22,500
AMT Exemption Phase-Out Range*		
Single or head of household	\$112,500 - \$299,300	\$112,500 - \$247,500
Married filing jointly or surviving spouse	\$150,000 - \$433,800	\$150,000 - \$330,000
Married filing separately	\$75,000 - \$216,900	\$75,000 - \$165,000

**The AMT income range over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.*

It's hard to plan without knowing for sure whether the patch will be extended. Accordingly, you can work with your MP&S tax advisor to project whether you're likely to be subject to the AMT with and without a patch, so you can keep this in mind in your decisions as year end approaches.

Shortly before Congress was scheduled to return from the mid-term election recess, the top four members of the Congressional tax-writing committees (in an unusual display of bipartisanship) sent a letter to the IRS Commissioner to assure him that they were committed to legislative AMT relief for 2010. Thus, it now seems likely that Congress will eventually "patch" the AMT for 2010.

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CAPITAL GAINS

Appreciated investments that don't generate current income aren't taxed until sold, allowing you to defer tax. So generally it's tax-smart to hold on to them as long as they're still achieving your investment objectives. But this year, that may not make sense in some situations.

If Congress does nothing, for 2011 capital gains rates will increase:

Maximum Capital Gains Rate*	2010	2011
For assets held 12 months or less (<i>short term</i>)	35%	39.6%
For assets held more than 12 months (<i>long term</i>)	15%	20%
Long-term gain that would be taxed at 15% or less based on the taxpayer's ordinary-income rate	0%	10%

*Different rates apply to some types of gain, such as gain attributable to certain recapture of prior depreciation on real property, gain on collectibles and gain on qualified small business stock held more than five years.

If you hold long-term highly appreciated investments, you may want to consider selling them before year end to lock in lower rates on the gain. Then if you're selling stock, for example, you can immediately buy more shares of the same stock to maintain your asset allocation, because the wash sale rules don't apply to gains.

So even if Congress extends the 2010 rates, the only downside likely will be that you'll have paid tax sooner than you otherwise would have had to. But if you'd prefer to avoid accelerating tax, you can wait to see what Congress does before you sell appreciated investments.

For appreciated investments you haven't held long term, you probably will be better off holding them at least until you've passed the one-year mark, because even the higher 2011 long-term rate would be lower than the 2010 short-term rate.

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INCOME INVESTMENTS

Ever since lower tax rates went into effect for “qualified” dividends, investments that have produced such dividends generally have been more attractive than other income investments. For example, interest from taxable bonds, money market accounts and certificates of deposit is still taxed at higher, ordinary income rates.

But this differing tax treatment will change in 2011 if Congress does nothing, because qualified dividends will again be taxed at ordinary income rates:

Maximum Rate on Dividends	2010	2011
Nonqualified dividends	35%	39.6%
Qualified dividends	15%	39.6%
Qualified dividends that would be taxed at 15% or less based on the taxpayer’s ordinary-income rate	0%	15%

Again, keep an eye on Congress. If it looks like no action is going to be taken to extend qualified-dividend tax treatment to 2011, you may want to revisit your asset allocation and sell some dividend-producing investments by year end. Of course, you first must consider your investment objectives; dividend-paying stock may be attractive even without the tax-favored status.

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EXPIRED TAX BREAKS

Numerous tax breaks expired at the end of 2009 or are scheduled to expire at the end of 2010. It's important to work with your tax advisor to determine which ones affect you and to monitor whether any legislation passes before year end. Here are some of the main ones to keep an eye out for:

Break	2009	2010	2011
Repeal of income-based phase-outs on itemized deductions and personal exemptions	Partial repeal of phase-outs	Full repeal of phase-outs	No repeal of phase-outs (phase-outs fully in effect)
State and local <i>sales</i> tax deduction in lieu of state and local <i>income</i> tax deduction	Available	Not available	Not available
Tax-free Sec. 529 plan distributions for certain technology expenses	Available	Available	Not available
Coverdell Education Savings Account (ESA): <ul style="list-style-type: none"> • \$2,000 contribution limit • Tax-free distributions for elementary and secondary education expenses 	Available Available	Available Available	Limit reduced to \$500 Only distributions used for qualified post-secondary education expenses are tax free
Ability to convert traditional IRA to Roth IRA	Limited to those with modified adjusted gross income (MAGI) of no more than \$100,000	No income limit. Can defer tax on conversion, splitting reporting of income 50/50 between 2011 and 2012	No income limit; all income must be reported in year of conversion
Direct, tax-free donation to charity from an IRA (up to \$100,000)	Available	Not available	Not available

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ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAXES

The Bush-era tax cuts (i.e., the Economic Growth and Tax Relief Reconciliation Act of 2001 or EGTRRA) phased in lower estate tax rates and larger exemption amounts over a 9-year period (with the estate tax repealed for a single year for 2010). At the end of the phase-in period in 2009, the estate tax exemption amount was increased to \$3.5 million with a top rate reduced to 45%. (The gift tax rates were likewise reduced, but the gift tax exemption was frozen at \$1 million during this period.)

Under EGTRRA, the federal estate and generation-skipping transfer (GST) taxes (but not the gift tax) are currently repealed for the single year 2010 (and replaced with a modified carryover basis regime for decedents dying during 2010). The gift tax exemption remains at \$1 million in 2010, but the tax rate is reduced to 35 per cent. EGTRRA then "sunset" after 2010, and unless Congress acts, the estate tax will be reinstated as of January 1, 2011 at pre-EGTRRA levels, with a top estate and gift tax rate of 55% (plus a 5% surcharge on taxable transfers between \$10 million and \$17,184,000) and a unified credit exemption equivalent of only \$1 million. The GST tax will likewise be reinstated as of January 1, 2011, and will be at a flat rate of 55% (i.e., the highest estate tax rate) with the GST exemption amount set at \$1 million, plus inflation adjustment (which will bring it up to approximately \$1.34 million for 2011).

Several bills have been introduced in Congress to reinstate the federal estate and GST taxes at 2009 or more favorable levels, but none of the proposals have garnered enough support so far to pass. In addition, there is still the possibility that Congress will attempt to retroactively reinstate the estate and GST taxes for 2010, although this is seen increasingly now as being unlikely.

While the present situation is highly uncertain, the unique circumstances in 2010 may nevertheless present potentially significant gift and GST year-end planning opportunities. A MP&S tax advisor can assist you in determining whether such planning may be applicable to your personal tax situation, given the potentially complex issues and factors involved.

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ONLINE TAX GUIDE

To facilitate ongoing access to the latest tax rules and regulations, the firm has launched an online tax guide. This web-based tax guide is updated as changes occur.

The online tax guide can be accessed directly at www.webtaxguide.net/markspaneth as well as through the firm's website at www.markspaneth.com. A link to the guide appears at the end of the Tax section (under Core Services) on our website.

If you have questions about anything you read in this alert or in the tax guide, please contact a MP&S tax advisor.

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FOR MORE INFORMATION

We've only touched the surface of the potential impact of scheduled tax law changes and possible congressional action on your year end tax planning. If you're a business owner, you also need to carefully consider business-related tax breaks as well as the impact of your business's structure on tax planning. And everyone needs to think about their estate planning strategies, because the estate tax is scheduled to return in 2011 at higher rates and a lower exemption than in 2009 if Congress doesn't take action.

With so much uncertainty, it's critical that you work closely with a MP&S tax advisor between now and the end of the year to ensure you're aware of the latest tax law changes and make tax-smart decisions for your particular situation.

Our professionals look forward to working with you to develop customized strategies to help you achieve your financial objectives. To learn more, please contact a MP&S tax advisor or Steven Eliach, JD, LLM, the Principal-in-Charge of the MP&S Tax Practice, by phone at 212.503.6388 or by email at seliach@markspaneth.com.

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