

November 2009

Dear Clients and Friends:

New tax legislation combined with President Obama's tax proposals and the scheduled sunset of many of the "Bush Tax Cuts" makes tax planning especially important during the next few years. This letter is intended to provide both general guidance on new tax laws and tax savings strategies. The ideas discussed below are general in nature and are intended only as an overview. We suggest that you review your situation with us before taking any action.

Our best wishes to you and your family for a healthy and happy 2010.

Sincerely,

FGMK, LLC



Tax Planning for 2009 and Beyond

PRESIDENT OBAMA'S PROPOSAL STARTING IN 2011

President Obama proposes to keep the current tax rates for families with income under \$250,000. For families with income over \$250,000, the 33% and 35% marginal ordinary tax rate brackets would increase to 36% and 39.6%, respectively. Additionally, the capital gains and dividend rates would increase from 15% to 20% on families with incomes over \$250,000. Obama also proposes to reinstate the personal exemption phase-out and itemized deduction limitations that are scheduled to expire in 2010. The increased tax rates and reinstatement of phase-outs would raise the top effective income tax rate to 41% in 2011. This likely rate increase plays a key factor in your income tax planning for the next few years.

For corporations, Obama had indicated he would reduce corporate tax rates for domestic businesses and pay for the rate reduction by repealing other business tax breaks and closing loopholes. He has proposed eliminating capital gains taxes on small businesses. He wants to eliminate special tax breaks for oil and gas companies, tax "carried interests" as ordinary income, and close international tax loopholes.

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NEW LEGISLATION

The most significant federal tax legislation enacted in the past year is the American Recovery and Reinvestment Act of 2009 and the recently enacted Worker, Homeownership, and Business Assistance Act of 2009.

The following is a summary of key components of the legislation:

- **2009 Net Operating Loss (“NOL”) Carryback** - 2009 NOLs for all taxpayers may be carried back up to five years (normally 2 year carryback). Only 50% of taxable income in the fifth carryback year can be offset by NOLs.
- **First-Time Homebuyer Credit** - Extended the first-time homebuyer tax credit of 10% of purchase price (maximum \$8,000) to home purchases under contract by May 1, 2010 and closed before July 1, 2010. The credit is phased out for single taxpayers with adjusted gross income (“AGI”) over \$125,000 and married couples with AGI over \$225,000. Unlike the credit first enacted in 2008, the revised credit granted in 2009 does not have to be repaid provided the taxpayers remain in the home for 36 months.
- **Long-time Resident Homebuyer Credit** - New credit of 10% of purchase price (maximum \$6,500) for home purchased by buyers who have lived in their present homes for 5 years. The same AGI limits apply as the first-time homebuyer credit.
- **Increased Section 179 Expense** - Extended the Section 179 expense limit on business property to \$250,000 for 2009 acquisitions.
- **Bonus Depreciation** - Extended 50% bonus depreciation on new business property purchased in 2009 (\$8,000 maximum bonus depreciation on automobiles).
- **Motor Vehicle Sales Tax Deduction** - Added a non-itemized deduction for a sales tax on new automobile purchases between 2/17/09 and 12/31/09 (phased out for singles with over \$125,000 AGI and married with over \$250,000 AGI).
- **Shortened S Corp Built-In Gains Period** - Temporarily reduced S corporation built in gain recognition period to 7 years from 10 years for the 2009 and 2010 tax years.
- **Energy Incentives** - Extended residential energy credit through 2010 and increased credit to 30% of qualified property (e.g., windows, doors, insulation, furnaces, hot water heaters), and increased combined maximum credit for 2009 and 2010 to \$1,500. Removed credit limits for solar electric, solar water, fuel cell technology and geothermal heat pumps. New incentives added for alternative fuel vehicles and plug-in electric vehicles.

- **Making Work Pay Credit** - Brand new for 2009 and 2010, individuals receive a credit of up to \$400 (\$800 if married), or 6.2% of earned income. Credit is refundable even if individual has no income tax liability. Credit phases out for singles with AGI between \$75,000 and \$95,000 and married taxpayers with AGI between \$150,000 and \$190,000. Dependents are not eligible.
- **Elect Deferral of Certain Debt Discharge Income** - Election is allowed to defer income from the discharge of business indebtedness resulting from reacquisition of the debt in 2009 and 2010. For 2009 debt discharges the income is deferred 5 years and then recognized ratably over the next five years. For 2010 debt discharges the income is deferred 4 years and then recognized ratably over the next five years. Special rules allow deferral to partners in a partnership resulting from decreases in a partner's share of liabilities resulting from the debt discharge.

TIMING STRATEGIES (for Businesses & Individuals)

Shifting the year in which one recognizes income or expense is a common year-end tax planning strategy. For example, cash method businesses may defer income by billing customers such that payment is received next year, or prepay certain expenses to accelerate deductions into the current year.

Individuals may consider optional medical services this year or next year in order to maximize deductible medical expenses, or to maximize use of their medical insurance deductibles.

Capital gain/loss planning is very important. Consider selling loss stocks to offset recognized capital gains (especially from mutual funds). Up to \$3,000 of capital losses in excess of capital gains can offset ordinary income. Be aware that the "wash sale" rule disallows stock losses if the stock is repurchased within 30 days.

Specific planning is needed when determining the most beneficial timing where the taxpayer has the flexibility of timing transactions. This is important when a taxpayer has the possibility of incurring some or all of the following, capital gains or capital losses, deductible business losses, large itemized deductions and potential net operating loss deductions. Absent good planning, benefits can easily be lost; proper planning can ensure maximizing tax benefits.

BUSINESS PLANNING

Business Entity Choices

Elect S Corporation Status - closely held C corporations should evaluate whether to change to S Corporation status to avoid potential double taxation (C corporation tax on profits and individual tax on C corporation dividends), and eliminate exposure to IRS claims of unreasonable compensation.

C Corporation Dividend - C corporations should consider paying dividends in 2009 or 2010 before the tax rate on qualified dividends increases from 15% to 20% in 2011. S corporations with prior C corporation's earnings should also evaluate this strategy.

Separate Leasing Entity - consider a separate flow-through entity to lease real estate or personal property to your business. This can be an effective strategy for reducing C corporation profits, or can reduce self-employment income in businesses operating in the partnership form.

Incorporate a Schedule C Business - consider incorporating your Schedule C business to reduce exposure to catastrophic liability and IRS audit risk.

IC-DISC (Interest Charged Domestic International Sales Corp.)

An IC-DISC is a special purpose entity that provides tax savings for U.S. businesses with foreign sales.

Cost Segregation for Real Estate

Cost segregation studies analyze architectural and engineering documents, cost data and other documents to separate out personal property and land improvements from the cost of buildings. The tax benefit is derived from the shorter lives, bonus depreciation, possible Section 179 deductions and accelerated depreciation of the property segregated from the building costs. These studies can be performed today on properties purchased in earlier years and the tax benefits can be realized immediately. Cost segregation studies can be performed on, and can achieve, significant tax benefits on existing properties acquired and on properties newly constructed.

In conjunction with a cost segregation study, an energy efficiency study should be performed. Under Section 179D, of the Internal Revenue Code, new improvements to a building certified as achieving certain energy efficiency under prescribed engineering rules can produce tax deductions of up to \$1.80 per square foot of the overall square footage of the building. There are three parts to the deduction and each part that qualifies produces a tax deduction of \$.60 per square foot up to the total allowable of \$1.80 per square foot. After deducting the energy deduction of \$1.80 per square foot, or part thereof, the building and related property can be depreciated utilizing the benefits of a cost segregation study as discussed above.

Research Credits

A simplified research & development credit may provide tax credit benefits to businesses that previously did not meet the increasing R&D expense thresholds or did not have the historical records to document the credit.

Standard Mileage Rates for 2009

The standard mileage rate for business travel during 2009 is 55 cents per mile. The 2009 medical and moving mileage rate is 24 cents per mile. The mileage rate for charitable deductions is 14 cents per mile for 2009.

RETIREMENT PLANNING

Beginning in 2010, taxpayers, regardless of income levels, are allowed to convert a regular IRA to a Roth IRA. Generally, the conversion is a taxable distribution but it is not subject to an early withdrawal penalty. The income from a 2010 conversion can be deferred 50% to 2011 and 50% to 2012. The benefit of a Roth IRA is all future distributions are tax-free, whereas all distributions from a regular IRA are subject to tax.

Maximizing your retirement plan contributions is a simple way to reduce your tax burden and save for retirement. The maximum retirement plan contributions (other than defined benefit plans) remain unchanged for 2009 and 2010 as follows:

<u>Type of Plan</u>	<u>2009</u>	<u>2010</u>
Traditional and Roth IRA Contributions limit	\$ 5,000	\$ 5,000
Simple IRA Contribution limit	\$11,500	\$11,500
Defined Contribution Plan limit	\$49,000	\$49,000
401(k) Elective Deferral limit	\$16,500	\$16,500
<u>Additional amounts allowed for age 50 and older:</u>		
Traditional and Roth IRAs	\$ 1,000	\$ 1,000
Simple 401(k)'s and Simple IRA Plans	\$ 2,500	\$ 2,500
401(k) Plans	\$ 5,500	\$ 5,500

MISCELLANEOUS INCOME TAX ITEMS

- **Capital Gains Rate** - For 2009-2010 the capital gains rate is zero for taxpayer's in the 10% and 15% regular tax brackets. Individuals in the 10% or 15% bracket should consider selling low basis stock. Consider gifting to your non-dependent children, if they are in the 10% - 15% tax brackets, stock for which you have an unrealized gain, and let your children sell the stock and incur the capital gain with zero capital gain tax.
- **Charitable Giving** - Individuals should consider the charitable contribution limitations in planning the tax benefits from gifting. The annual charitable deduction is generally limited to 50% of adjusted gross income. Note that charitable contributions subject to limits carryover for five years. Through the end of 2009, tax-free IRA distributions of up to \$100,000 can be made to public charities if the taxpayer is at least age 70 1/2. The distribution is not taxable and the contribution is not deductible. This can have better results than if one were to receive a distribution from an IRA, report it as income and then make an equivalent donation. Various deduction phase outs and other items are based on income and avoiding income by making direct donations from an IRA can keep income down.
- **“Kiddie Tax” Change** - The “Kiddie Tax” imposes tax on 2009 children's income over \$1,900 at the parents' tax rate. Starting in 2008, the Kiddie Tax applies to all children under age 19 and students under age 24.

- **Flexible Spending Accounts** - Maximize use of your flexible spending accounts with your employer to pay for items such as child care and medical expenses with pre-tax dollars. Also, most plans allow for expenses incurred through March 15th of the following year to be recovered against prior year contributions.
- **Section 529 Plan** - Consider using a Section 529 plan to fund college in the future. The earnings in a Section 529 plan are not taxed if the funds are used for college education. Up to \$10,000 (\$20,000 if married filing joint) of contributions to Illinois Bright Start, Bright Directions College Savings Pools and College Illinois Prepaid Tuition Program are deductible on your Illinois income tax return.
- **Tax Basis** - Review your tax basis in S corporations, partnerships, and limited liability companies (LLCs) with losses. Consider making capital contributions or lending to the entity to create sufficient basis to claim the losses. The ramifications of making a loan for tax basis versus a capital contribution should be reviewed as the two can produce differing results.
- **IRA and Other Retirement Plan Minimum Distributions** - Required minimum distributions are suspended for 2009 and do not have to be made.
- **Health Savings Accounts** - For those with a “high-deductible” health insurance policy, consider contributions to a health savings account (“HSA”). The contributions are deductible and withdrawals to pay medical expenses are tax-free. Unlike a flexible spending account, the contributions can accumulate tax-free year after year.
- **Wage Withholding** - Check your taxes withheld from your paycheck; and, if necessary, make special withholding payments before year-end to avoid potential underpayment penalties. Special withholding or a change to your exemptions is made with your employer on Form W-4.
- **Withholding on Retirement Plan Distributions** - If withholding taxes are needed and may be inadequate from wages, consider having withholding from retirement plan contributions.

GIFT AND ESTATE TAX

Annual Gift Tax Exclusion

The amount of your taxable estate can be reduced by making lifetime gifts. Under the annual gift tax exclusion, 2009 and 2010 gifts of up to \$13,000 to any person are not taxable. If you are married, each spouse can give \$13,000 each to the same person. For example, a married couple could reduce their estate by \$234,000 per year by making gifts to three children and six grandchildren. Also, payments in any amount directly to an educational institution or a medical provider for any person’s education or medical care are exempt from gift tax.

Cash gifts in excess of the \$13,000 exclusion are subject to gift tax and require a gift tax return. However, the first \$1 million of taxable gifts do not result in current tax, but effectively use up part of your estate tax exemption.

Estate Tax

Under current law, the amount of your estate exempt from estate tax is as follows:

Year	Exempt Amount	Top estate tax rate
2009	\$3.5 million	45%
2010	All Exempt	Repealed
2011	\$1 million	55%

It is highly probable that legislation will be enacted before year-end that reinstates the estate tax for 2010. Legislation will likely either extend or make permanent the 2009 estate exemption amount of \$3.5 million and maximum tax rate of 45%. With the changing estate tax law, a regular review of your estate plan is essential to minimize your potential estate tax. Your estate and gifting strategies should also be reviewed to consider:

- A life event such as marriage, divorce, births, deaths, job changes, move, etc.
- Whether chosen fiduciaries (executors, guardians, and trustees) are still appropriate.
- Whether life insurance policies, retirement plans, etc. have the intended beneficiaries.
- Whether assets are held in the proper name, such as your living trust.
- The effect your plan will have on incurring State estate/inheritance taxes that may not have been anticipated while planning around the Federal estate tax.
- Gifting interests in operating businesses or family investment partnerships.
- Gifting retirement accounts to charity.

Estate plans also need to be reviewed for the impact of State inheritance/estate taxes. Under many estate plans, there is no Federal estate tax upon the death of the first spouse. In certain States, such as Illinois, there could be inheritance/estate tax on the death of the first spouse. To eliminate the tax, certain changes in a plan can be made. Additionally, revisions should be made to ensure State inheritance/estate tax exemptions will be used to their maximum benefit.

Through basic gifting strategies a significant amount of assets can be transferred out of your estate without paying any estate or gift tax. The transfer of assets also removes the future appreciation of those assets from your estate. More sophisticated strategies are available to transfer more substantial assets to second and third generations.

As a result of the decline in asset values during the past two years, now is an extraordinary time to do inter-family transfers of businesses, stock portfolios, real estate and other assets. We can assess strategies that will accomplish your goals and assist in implementing such strategies.



CAUTION

The year is not over, and Congress may still pass tax legislation that could affect your tax situation.



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