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INTRODUCTION

You pay federal income taxes every year, but are you paying too much? Everyday financial decisions and transactions can affect your taxes more than you may realize. This *2009 Tax Planning Guide* explains how taxes fit into your financial life and provides pointers for trimming your tax bill.

Before acting on any of the general information presented in this booklet, you should obtain professional advice.

Reviewing your specific situation with your advisor can help you select strategies that are right for you.





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Key developments include the following:

Individuals who purchase their "first" home before July 1, 2009, may be entitled to a tax credit.

Gain on the sale of a principal residence that the owner previously used as a vacation home or rental property could be taxable, even if the tax law's capital gain exclusion otherwise applies to the sale.

State and local real property taxes of up to \$500 (\$1,000 for married individuals filing jointly) are deductible as an additional standard deduction in 2008 and 2009.

Taxpayers who itemize their deductions again have the option of deducting state and local general *sales* taxes instead of state and local *income* taxes on their 2008 and 2009 returns.

Two education-related deductions — one for the payment of higher education expenses and another for classroom-related expenses incurred by eligible K-12 educators — have been extended through 2009. (Limits apply.)

Also extended for 2008 and 2009 is a provision allowing taxpayers who have reached age 70½ to roll over money in individual retirement accounts (IRAs) to qualified charities on a tax-free basis. As much as \$100,000 may be donated annually.

Estates of up to \$3.5 million may avoid federal estate tax in 2009. The estate tax is repealed for 2010 and returns in 2011 with a \$1 million effective exemption.





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GETTING STARTED

Many tax-saving strategies aim to reduce *taxable income*. The goal, of course, is not to generate less income. Instead, the focus of your tax planning might be to find ways to have your income taxed at a lower rate, defer taxes on your income, or increase the amount of deductible expenses.

In looking at potentially deductible expenses, you'll want to identify those that are deductible in arriving at your adjusted gross income (AGI). Because many tax benefits are not available once AGI exceeds specified levels, claiming as many of these "above-the-line" deductions as possible can be very beneficial.

In addition to any above-the-line deductions you may have, you may claim either a standard deduction, set by the IRS annually, or specific actual expenses, called itemized deductions. You also may deduct personal exemptions for yourself, your spouse, and your dependents.





Each personal exemption you can claim in full reduces your taxable income by \$3,650 in 2009. However, your deduction must be reduced if your AGI is more than \$166,800 if you are a single filer, \$208,500 if you file as a head of household, \$250,200 if you are a married person filing jointly, or \$125,100 if you are a married person filing separately.

The table on the next page shows the federal income-tax rate schedules. Notice that they are graduated. This means that your income is taxed in stages — a certain amount at the lowest 10% rate, an amount over that at the 15% rate, and so on. The IRS adjusts the income brackets for inflation every year.





Individual Tax Rate Schedules

| Filing Status | Rate (%) | Taxable Income (\$) Brackets |
|--|----------|------------------------------|
| Single  | 10 | 0 – 8,350 |
| | 15 | 8,351 – 33,950 |
| | 25 | 33,951 – 82,250 |
| | 28 | 82,251 – 171,550 |
| | 33 | 171,551 – 372,950 |
| | 35 | Over 372,950 |
| Head of Household  | 10 | 0 – 11,950 |
| | 15 | 11,951 – 45,500 |
| | 25 | 45,501 – 117,450 |
| | 28 | 117,451 – 190,200 |
| | 33 | 190,201 – 372,950 |
| | 35 | Over 372,950 |
| Married Filing Jointly (& Surviving Spouses)  | 10 | 0 – 16,700 |
| | 15 | 16,701 – 67,900 |
| | 25 | 67,901 – 137,050 |
| | 28 | 137,051 – 208,850 |
| | 33 | 208,851 – 372,950 |
| | 35 | Over 372,950 |
| Married Filing Separately  | 10 | 0 – 8,350 |
| | 15 | 8,351 – 33,950 |
| | 25 | 33,951 – 68,525 |
| | 28 | 68,526 – 104,425 |
| | 33 | 104,426 – 186,475 |
| | 35 | Over 186,475 |





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ALTERNATIVE MINIMUM TAX

Even if you've never had to pay the alternative minimum tax (AMT), you've probably heard about it. Basically, the AMT is a separate tax intended to ensure that taxpayers who claim certain deductions and make use of other tax benefits to reduce their taxable income still pay a minimum amount of tax. When your AMT liability is more than your regular income-tax liability, you must pay that extra amount on top of your regular income tax. Although lawmakers have discussed reforming the AMT system, for now it may be a significant factor in your planning.

The interest on certain "private activity" municipal bonds has to be included in your income for AMT purposes, even though the interest is otherwise tax exempt.

State and local taxes and miscellaneous itemized expenses aren't deductible in computing the AMT. Deferring some of these expenses from a year when you are subject to the AMT to a non-AMT year may result in overall tax savings.

If your marginal tax rate is greater than the top AMT rate of 28%, accelerating income into a tax year when you will be paying the AMT anyway may result in overall savings.

Exercising incentive stock options can lead to an AMT liability. Why? The difference between the exercise price and the market value of the underlying stock on the exercise date is taken into account in computing AMT income.





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UNCOVERING TAX SAVINGS AT HOME

The tax law encourages homeownership. So it's not surprising that one of the best places to uncover potential tax breaks is right at home.



Mortgage interest. You may deduct interest paid on up to \$1 million borrowed to buy or build your principal and/or second residence, assuming the debt is secured by your home. (Other limits and requirements apply.) You also may deduct interest paid on up to \$100,000 of home equity debt incurred for any purpose.

If you qualify, you may treat mortgage insurance premiums as deductible home mortgage interest. The deduction is available only for post-2006 insurance contracts issued in connection with the acquisition of your residence. The mortgage insurance deduction is phased out with AGI between \$100,000 and \$109,000 (\$50,000 and \$54,500 for married individuals filing separately).





Any points you pay to secure a home mortgage for the purchase or construction of a qualifying residence are generally fully deductible in the year paid. But what happens if you don't have enough deductions to make itemizing worthwhile in the year you buy your home? In that case, try for a deduction again next year. The tax law gives you the option of deducting points ratably. If you itemize in the future, you'd receive a partial deduction in the following year and for each of the remaining years of your mortgage.

Points paid in connection with the refinancing of a mortgage on your principal residence or a second home also may be tax deductible. You generally must spread out the deduction over the new loan's term. However, to the extent the refinancing is for improvements to your principal residence, you may currently deduct points paid from separate funds.

Selling your residence. If you make a profit when you sell your home, all or part of the gain may be tax free. The maximum exclusion is \$250,000 (\$500,000 for married persons filing jointly). Generally, you may claim the exclusion only once every two years, and you must have owned and used the home as a principal residence for at least two of the five years immediately before the sale. However, if you sell your home before you meet the two-year tests due to a change in employment, for health reasons, or because of certain other unforeseen circumstances, you still may exclude gain, but the \$250,000/\$500,000 exclusion cap is prorated.

You may lose some of the benefit of the capital gain exclusion if you sell a residence that you previously used as a vacation home or rental property. Under a new rule that takes effect in 2009, the portion of your gain that is allocable to the time you didn't use the home as your principal residence may be taxable.





In general, the \$500,000 exclusion is available only if you file a joint tax return with your spouse. However, as a surviving spouse, you may make use of the \$500,000 exclusion for a home sale that occurs within two years of your spouse's death, provided you haven't remarried as of the sale date and the two-year rule was met immediately prior to your spouse's death.

Home rentals. Income from the rental of your main residence or second home for fewer than 15 days during the year is tax free. In this situation, if you have rental expenses, such as advertising, you may not deduct them. However, you may still deduct qualifying mortgage interest and property taxes. If you rent your home for 15 days or more, you must report the rental income and you may deduct your rental expenses, within limits. We can tell you more about these rules.

First-time homebuyers. A tax credit of up to \$7,500 is available for the purchase of a principal residence after April 8, 2008, and before July 1, 2009, by a first-time homebuyer. But the tax law's phrase "first-time" is a little misleading. You can qualify as long as you haven't owned a principal residence in the U.S. during the three years before your home purchase. (If you are married, both you and your spouse must meet this requirement.) However, the credit phases out for taxpayers with modified AGI between \$75,000 and \$95,000 (\$150,000 and \$170,000 for joint filers).

Unlike most tax credits, this one has to be repaid over 15 years, making it more like an interest-free loan from the government. Selling the home before the end of the 15-year period generally will trigger an obligation to repay the remaining credit in that tax year.





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TAX BREAKS ON THE JOB

Although often overlooked, certain employment-related expenses are tax deductible. Employee business expenses are deductible as an itemized deduction. They are combined with certain other miscellaneous expenses you may have, and only the amount that exceeds 2% of your AGI is deductible.

Job hunting expenses. The expenses of a job search, such as resume preparation expenses and transportation to job interviews, are potentially deductible. However, you may not deduct job search expenses if you are looking for your first job, if there was a “substantial break” between your last job and the start of your search for a new one, or if you are switching careers.

Commuting. The costs of driving or taking public transportation between your home and your main place of work are nondeductible personal expenses. However, if you work at two places in one day — whether for the same employer or for two different employers — you may deduct the unreimbursed expenses of getting from one workplace to another.

Example

After she finishes her shift working in a hospital lab, Megan commutes to a second job teaching night classes at the community college near her home. If Megan itemizes deductions on her tax return, she will be able to deduct her commuting expenses, subject to the 2%-of-AGI floor on miscellaneous expenses.





Telecommuting. Does your employer require you to work at home? If you maintain a home office (an area in your home that you use exclusively and regularly for business purposes) you may be able to deduct home office expenses, such as a portion of your utility bills. The office must be maintained for your employer's convenience. Self-employed individuals who work from home also may qualify for a home office deduction. We can give you the details.



Other employee business expenses. Your business travel, entertainment, and car expenses are deductible if your employer does not reimburse you for them. You also may deduct reimbursed expenses if your employer includes the payments in your taxable wages (on Form W-2). However, if your expenses are reimbursed under an arrangement that meets the tax law's "accountable plan" requirements, the reimbursements should not be included in your wages and you won't be entitled to a deduction for the expenses. Very generally, an accountable plan is one that reimburses employees for the exact amount of their appropriately documented business expenses.





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PAYING FOR COLLEGE

Are you saving for a child's future education expenses or do you have a child attending college or graduate school now? For many families, higher education costs are a significant financial concern. Several tax provisions may be helpful.



529 plans. Prepaid tuition and college savings plans, also called qualified tuition programs or 529 plans, are tax-advantaged plans designed specifically for college savers. Contributions to a 529 plan are not deductible, but distributions from the plan to pay for the qualified education expenses of the plan beneficiary are tax free. You're not limited to the 529 plan offered by your state. However, certain benefits may not be available unless specific requirements, such as state residency, are met. A particular plan also may have restrictions on the timing and use of plan distributions. *Before investing in a 529 plan, consider the investment objectives, risks, and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.*

If the child you've named as beneficiary of a 529 savings plan decides not to go to college, you can typically switch the account to another child. Or you have the option of closing the account and taking the money back. At that point, the account earnings would be taxed and subject to a 10% penalty.





Coverdell ESAs. Another tax-advantaged option for educational savings, the Coverdell education savings account (ESA), is available at many financial institutions. Annual ESA contributions for a child can't be more than \$2,000, and they are not tax deductible. However, all account withdrawals, including withdrawals of investment earnings, are income-tax free if used for the child's qualifying education expenses. Unlike a 529 plan, which has no income restrictions, the allowable ESA contribution is phased out for taxpayers having modified AGI between \$95,000 and \$110,000 (\$190,000 and \$220,000 for joint filers).

ESA funds may be used for elementary and secondary school expenses, as well as for higher education expenses.

Scholarships. If your child receives a scholarship, it may be tax free, but certain requirements apply. One requirement for tax-free status is that your child be a candidate for a degree. Also, the scholarship must be used for tuition and fees required for enrolling in or attending the educational institution or for required course-related fees, books, supplies, and equipment. Scholarships spent on room, board, travel, and other expenses are taxable, as are scholarships that represent payment for teaching, research, or other services. A portion of a scholarship could be considered taxable and another portion tax free. For example, if a scholarship requires your child to serve as a part-time teaching assistant, the portion of the scholarship that represents payment for teaching would be taxable — even if used for tuition and other course-related expenses.

Student loan interest. Up to \$2,500 of interest paid on qualified higher education loans is deductible above the line. (So you need not itemize to claim the deduction.) In 2009, the interest deduction is phased out for singles with modified AGI between \$60,000 and \$75,000 and for joint filers with income between \$120,000 and \$150,000.

Tax credits. Tax credits offset your tax liability dollar for dollar. There are two tax credits for the payment of higher education expenses. The *Hope Scholarship* credit is up to \$1,800 per student and is available for tuition and related fees paid for the first two years of post-secondary education. The *Lifetime Learning* credit is limited to \$2,000 per taxpayer





return and is available for each additional year of post-secondary education, including graduate school and eligible job training. Both credits are phased out in 2009 with modified AGI between \$50,000 and \$60,000 (\$100,000 and \$120,000 on a joint return).

Tuition deduction. If an education credit is not claimed for a student's higher education expenses, a limited amount of tuition and related expenses may be deductible. The deduction is capped at either \$2,000 or \$4,000, depending on income. No deduction is available if modified AGI is more than \$80,000 (\$160,000 on a joint return).





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GIVING BACK

Every year, Americans donate billions of dollars to charitable organizations and spend countless hours working as volunteers. For those who itemize their deductions, charitable contributions can lead to tax savings.

Cash contributions. To claim a deduction for a gift to a qualified organization, you will need a written receipt from the charity or a canceled check or other bank record showing the charity's name and the amount and date of your contribution. For contributions of \$250 or more, you'll need a written acknowledgment.

If the organization provides something of value in return for your donation, your deduction generally is limited to the amount over and above the value of the goods or services you receive. There is an exception that allows a full deduction in the case of insubstantial and token benefits.

Non-cash donations. If you own marketable securities that have increased in value, consider donating them directly instead of making a cash contribution. You'll generally be entitled to deduct the full market value of the donated securities as of the date of the donation. In addition, you'll sidestep the taxable capital gain you would have had if you'd sold them.

Example

Doug has been very active in the local hospital's fundraising efforts over the years. Now he wants to make a substantial donation. The hospital is eligible to receive tax deductible contributions. Doug decides to contribute securities that are currently worth \$100,000. Although Doug originally paid \$40,000 for the securities, none of the \$60,000 appreciation will be taxable. Subject to the tax law's income-based limitations on charitable contributions, Doug will be entitled to a \$100,000 deduction for his donation.





Consider taking the opposite approach if your securities have lost value. By selling the securities first, then donating the cash proceeds, you'll be able to claim a capital loss on the sale *and* a deduction for your cash contribution (both subject to tax law limits). If you simply donate the securities, you won't receive a deduction for their decline in value.



Volunteering. Although the value of your volunteer service is not tax deductible, you may deduct various out-of-pocket expenses incurred in connection with your volunteer work for qualified charitable organizations. These expenses include:

Lodging, meals, travel, and transportation costs associated with traveling away from home on behalf of a charity (unless the travel is in connection with lobbying activities)

Gas, oil, and other unreimbursed auto expenses incurred while performing services for a charity or 14 cents per mile, plus tolls and parking

The cost of uniforms worn while volunteering, but only if the uniforms have no general use

Expenses associated with entertaining others on behalf of a charity





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INVESTMENTS AND RETIREMENT SAVINGS

When you invest, keeping your tax burden on your transactions as low as possible will effectively increase your after-tax returns. To hold down your taxes, you also should take advantage of any opportunities you have to save and invest for your retirement in tax-favored accounts.

Capital gains. The maximum tax rate on long-term capital gain is generally 15% through 2010. That compares very favorably to the top tax rate of 35% that applies to ordinary income, such as interest and wages. Even better, there is a 0% rate on long-term capital gain that otherwise would be taxed in the lowest two regular brackets — in other words, that gain is not taxable. You generally must hold an investment for more than one year to qualify for this beneficial tax treatment.

Certain assets are treated differently. For example, gain on the sale of collectibles is taxed at a maximum 28% rate. For real estate, the maximum long-term capital gains rate is 25% to the extent of prior depreciation on the property.

If you own mutual fund investments outside of tax-deferred plans, you generally will realize a capital gain or loss when you sell or redeem your shares. Also, because the funds themselves buy and sell securities, some of the income you receive from fund investments may be a





distribution of capital gains. These gains are reportable on your return, even if you haven't sold any of your fund shares. The mutual fund should report the amount of gain that's eligible for the long-term rate.

You should consider a mutual fund's investment objectives, charges, expenses, and risks carefully before you invest. The fund's prospectus, which can be obtained from your financial representative, contains this and other information about the fund. Read the prospectus carefully before you invest or send money. Shares, when redeemed, may be worth more or less than their original cost.



Capital losses. You may deduct capital losses dollar for dollar against your capital gains. An additional \$3,000 of capital loss is deductible against your other income. (The limit is \$1,500 for married individuals filing separately.) You may carry forward any unused capital losses for deduction in later tax years, subject to the same restrictions.

For the best tax treatment, wait a minimum of 31 days to repurchase securities that are substantially identical to those you've sold at a loss. Otherwise, the loss on the original sale won't be deductible.

Dividends. Like capital gains, dividends receive favorable tax





treatment. Through 2010, you'll generally pay tax on dividends received from qualifying stock and stock mutual fund investments at a maximum rate of 15%. In the lowest two regular brackets, dividends are tax free. To qualify for favorable dividend treatment, stock must be held for a certain period of time.

Tax-exempt bonds. Municipal bonds generally pay investors less interest than comparable bonds that pay taxable interest. The reason: Municipal bond interest is generally free of federal income taxes and, usually, state income taxes in the issuing state. For this reason, individuals in higher income brackets often consider tax-exempt municipal bonds to be an attractive investment.

The accompanying table shows you the taxable yield you would need to match a given tax-exempt yield.

| Tax-exempt Yield | 25% Bracket | 28% Bracket | 33% Bracket | 35% Bracket |
|------------------|-------------|-------------|-------------|-------------|
| 3.0% | 4.00% | 4.17% | 4.48% | 4.62% |
| 3.5% | 4.67% | 4.86% | 5.22% | 5.38% |
| 4.0% | 5.33% | 5.56% | 5.97% | 6.15% |
| 4.5% | 6.00% | 6.25% | 6.72% | 6.92% |
| 5.0% | 6.67% | 6.94% | 7.46% | 7.69% |

Employer-sponsored retirement plans. You can save for





your retirement *and* lower your tax bill by contributing to a 401(k) or similar tax-deferred plan sponsored by your employer. When you make pretax contributions, the amount you contribute is not included in your wages for federal income-tax purposes. The money you save in taxes effectively lowers the out-of-pocket “cost” of saving in the plan. For example, if you are in a 25% tax bracket, it costs you only 75 cents to save one dollar in the plan. Your account’s investment earnings — interest, dividends, and capital gains — are also tax deferred. You won’t pay tax on contributions or earnings until you receive plan distributions. With no taxes taken out, your savings can potentially grow and compound more rapidly.

A 401(k) or 403(b) plan also may offer participants a Roth contribution option. Unlike pretax contributions, Roth contributions are made with money that has been taxed to you. Roth account earnings accumulate tax deferred. With a Roth, the biggest tax benefit comes when you receive distributions. After five years, distributions of both contributions and related earnings are tax free, provided you have reached age 59½ (or in certain other situations).



IRAs. Individual retirement accounts also offer tax benefits. If neither you nor your spouse actively participates in an





employer-sponsored retirement plan, your entire allowable contribution to a traditional IRA is tax deductible — *no matter how high your income*. However, if you or your spouse is an active plan participant, you can still contribute, but your deduction may be limited or eliminated if your modified AGI exceeds certain levels (see table).

**Traditional IRA Contribution Deduction
Income Phaseout Ranges for Plan Participants**

Deductions for traditional IRA contributions are phased out for plan participants whose modified AGI falls in these ranges.

| Filing Status | 2008 | 2009 |
|---------------------------|----------------------|----------------------|
| Unmarried | \$53,000 – \$63,000 | \$55,000 – \$65,000 |
| Married Filing Jointly* | \$85,000 – \$105,000 | \$89,000 – \$109,000 |
| Married Filing Separately | \$0 – \$10,000 | \$0 – \$10,000 |

** A spouse who does not participate in an employer-sponsored plan may deduct IRA contributions even if the other spouse participates in a plan. The deduction is phased out, though, with joint AGI between \$159,000 and \$169,000 in 2008 and between \$166,000 and \$176,000 in 2009.*

Contributions to a Roth IRA are not tax deductible — but you may withdraw Roth contributions tax free at any time. And withdrawals of account investment earnings are also tax free if taken more than five tax years after your first contribution to a Roth IRA and you are age 59½ or older. Tax-free





withdrawals of earnings after five years are also permitted upon your disability or death or for the payment of first-time homebuying expenses of up to \$10,000.

**Roth IRA Contributions
Income Phaseout Ranges**

The allowable Roth IRA contribution is phased out for taxpayers whose modified AGI falls within these ranges.

| Filing Status | 2008 | 2009 |
|---------------------------|-----------------------|-----------------------|
| Unmarried | \$101,000 – \$116,000 | \$105,000 – \$120,000 |
| Married Filing Jointly | \$159,000 – \$169,000 | \$166,000 – \$176,000 |
| Married Filing Separately | \$0 – \$10,000 | \$0 – \$10,000 |

You may make IRA contributions of up to \$5,000 per year (annual limit for 2008 and 2009), as long as you earn at least that much compensation. Married couples may contribute as much as \$10,000 to their respective IRAs (\$5,000 for each spouse), even if one spouse does not have earnings, as long as their contributions aren't more than the compensation reported on their joint return. An additional \$1,000 "catch-up" contribution is allowed for individuals age 50 or older. These dollar limits are for your total annual contributions to all the IRAs you maintain — both traditional and Roth.





Roth IRA conversions. If your modified AGI is not more than \$100,000, and your filing status is not married filing separately, you may convert an existing traditional IRA (deductible or nondeductible) to a Roth IRA. An early distribution penalty won't apply, although regular income taxes are payable on any taxable amounts converted.

Starting in 2010, you may convert a traditional IRA into a Roth IRA regardless of your filing status and how high your income is. A special benefit applies if you convert your IRA in 2010. Unless you elect otherwise, you may spread the income from a 2010 conversion (and pay the resulting income taxes) over the next two years — 2011 and 2012. Normally, the full amount of the income resulting from a conversion has to be included on your return for the year of the conversion.

Before you convert to a Roth IRA, check into the tax implications that such a conversion may have for you. There could be “hidden costs” involved. For example, the conversion may put you into a higher tax bracket, or, if you are receiving Social Security, the conversion could affect the percentage of your benefits subject to tax. It





also could affect your eligibility to take certain tax deductions and credits. Still, converting to a Roth IRA may be very beneficial. Let us help you decide.

If you are deciding whether to contribute to a deductible IRA or a Roth IRA, you'll want to consider several variables, including your age, your current tax bracket, and your expected future tax situation. A Roth contribution may be particularly attractive if you have taken full advantage of other tax-deferred contributions available to you, especially to retirement plans that offer an employer matching contribution. But each situation is different, so talk to us before you decide.





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HEALTH CARE AND SOCIAL SECURITY

With the increases in health-care costs and insurance rates in recent years, medical expenses can add up quickly. You may want to keep track of your medical expenses even if you haven't qualified for a deduction in the past — just in case you become eligible for a deduction.



7.5% floor. Medical expenses are deductible as an itemized deduction to the extent they, in total, exceed 7.5% of AGI. For example, a family with AGI of \$75,000 would have to spend more than \$5,625 on *unreimbursed* medical expenses to qualify for any deduction. That 7.5% hurdle may seem high, but the list of medical expenses that can qualify for the deduction is quite long. Among other expenses, it includes:

Health insurance premiums

Doctors' bills

Oxygen

Prescriptions

Psychiatric care





Dental work

Eyeglasses, contact lenses, eye surgery to correct defective vision

Hearing aids

Laboratory fees

Nursing home costs (if a person is not there principally for medical reasons, generally only the cost of the medical care qualifies)

Child's tuition at a school to treat learning disabilities, such as dyslexia

Stop-smoking programs

Surgery

Weight-loss programs for treatment of a specific disease

Transportation expenses. You also may deduct the costs of transportation primarily for and essential to medical care. These costs include food and lodging expenses incurred en route to the place of medical treatment (within limits), as well as taxi, train, plane, and bus fares and ambulance costs. If you travel by car, gas and oil expenses are deductible, or you may figure your deduction using a flat mileage rate provided by the IRS.

Improvements. The cost of an elevator, swimming pool, or other permanent improvement to your property may be deductible if its primary purpose is for medical care. If the improvement increases the value of your property, your deduction is limited to the amount of the expense over and above that increase in value.

Health savings accounts (HSAs). Available only to individuals enrolled in eligible high deductible health plans, health savings accounts offer tax deductible contributions and tax-free distributions for the payment of qualified medical





expenses. Annual contributions for 2009 are capped at \$3,000 for those with self-only coverage and \$5,950 for those with family coverage. Contributions are deductible above the line, so you need not itemize to gain a deduction.

Any amount left in your HSA at the end of a year may be used to pay your future medical expenses.

Once in your lifetime, you may roll over a limited amount of funds from an IRA to an HSA. The transfer is tax free. Since withdrawals from your traditional IRA to pay medical expenses would be taxable, as opposed to the tax-free treatment available for HSA withdrawals, rolling over some of your IRA to an HSA could be a smart strategy.

Social Security benefits. If you are collecting Social Security, you could be taxed on a portion of your benefits. The amount subject to tax hinges on your "provisional income" — your AGI with certain modifications, plus one half of your Social Security benefits. Significantly for many retirees, otherwise tax-exempt municipal bond interest is *included* in modified AGI for this purpose.

You will be taxed on up to 85% of your Social Security benefits if you have provisional income of more than \$34,000 (\$44,000 for a married couple filing jointly). If your provisional income is between \$25,000 and \$34,000 (between \$32,000 and \$44,000 on a joint return), up to 50% of your benefits will be taxable. Because these income brackets are *not* adjusted for inflation, more retirees are finding that they owe tax on their Social Security.

If your Social Security benefits will be heavily taxed in 2009, think about the possibility of changing your investment mix to include more growth-oriented investments that would allow you to delay the recognition





of gains. Rental real estate that produces a tax loss also may be a tax friendly investment if you can take advantage of the tax law's special \$25,000 passive loss allowance. Naturally, your income needs and other investment considerations should take precedence in any investment decisions you make.

To lower your provisional income — and potentially reduce the taxes on your Social Security — consider paying off debts using invested funds that are earning interest or dividends. You'd give up the income you were receiving on your investments, but you'd no longer have to make payments on the debt.

If you rely on withdrawals from a traditional IRA as a source of income, you may want to take enough money out of your IRA to last for two years. Your provisional income will be higher in the withdrawal year, but you'll have less income — and potentially less tax to pay on your Social Security — the following year. Of course, after you reach age 70½, you'll have to take enough each year to satisfy your required minimum distribution (RMD) requirement.





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HOW BUSINESS INCOME IS TAXED

How your business is organized affects how its profits are taxed — as well as the tax-reducing strategies that may prove useful for you and any other owners. You'll want to review the various forms of business as part of a comprehensive income-tax plan. Although non-tax considerations are critical in choosing a form of business, tax matters also play a role.

A regular "C" corporation pays federal income tax at the rates shown in the accompanying table and also could be subject to the corporate alternative minimum tax.

| Taxable Income | Rate |
|----------------------------------|------|
| Up to \$50,000 | 15% |
| \$50,001 – \$75,000 | 25% |
| \$75,001 – \$100,000 | 34% |
| \$100,001 – \$335,000 | 39% |
| \$335,001 – \$10 million | 34% |
| Over \$10 million – \$15 million | 35% |
| Over \$15 million – \$18,333,333 | 38% |
| Over \$18,333,333 | 35% |
| Alternative Minimum Tax | 20% |

The corporate AMT exemption of \$40,000 is phased out with alternative minimum taxable income between \$150,000 and \$310,000.





Dividend distributions paid to shareholders from corporate earnings and profits are not tax deductible and must be reported as income by the shareholders. Essentially, corporate income paid out as a dividend is taxed two times — once to the corporation and again to the shareholders. By paying shareholders who are employed by the firm reasonable salaries and bonuses on a tax-deductible basis, a corporation can lessen the impact of double taxation.

If you are an owner of a closely held corporation, you may want to review your corporate and personal tax situation annually to determine an appropriate level of compensation.

Under current law, corporate dividends meeting certain requirements are taxed to individual shareholders at a relatively low rate — no more than 15%. Qualified dividends that otherwise would be taxed in the lowest two individual tax brackets are tax free. Because this highly favorable tax treatment is set to expire after 2010, corporations should take this opportunity to evaluate the possibility of paying dividends.

A "small corporation" is not subject to the AMT. This exemption applies where average annual gross receipts for all three-year periods beginning after 1993 and ending before the current year don't exceed \$7.5 million. For the first three-year period, a \$5 million average gross receipts threshold applies.





Pass-through taxation. Instead of paying tax at corporate rates, a corporation meeting certain requirements may elect to be taxed as an “S” corporation. An S corporation generally isn’t taxed on its income at the federal level. Instead, the company’s income, deductions, losses, and credits are divided up and taken into account by the shareholders on their own tax returns. The double taxation that can be a problem with a regular C corporation is avoided.

Example

After they incorporated their business, Jamie and Maria filed a timely S election with the IRS. The first year, the company had taxable income of \$60,000. That income was not taxed to the corporation. As equal shareholders, Jamie and Maria each included \$30,000 of the corporate income on their personal returns.

Partnerships, limited liability companies (LLCs) taxed as partnerships, and sole proprietorships are other entities that avoid two layers of income tax. If you have any specific questions about these business forms and how they can meet your needs, please let us know.

Spouses who own and operate an unincorporated business may elect to be taxed as a qualified joint venture instead of a partnership. Making the election avoids the





need to file a separate partnership return for the business.

Net operating losses (NOLs). If your business shows a loss for the year, the silver lining is that it may provide a tax benefit. A C corporation's NOL is taken into account at the corporate level. S corporation shareholders and owners of unincorporated businesses account for NOLs on their personal returns.





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BUSINESS DEDUCTIONS

As a business owner, you already are familiar with many of the expenses you can deduct for tax purposes. But some potential deductions are easily overlooked.

Meal and entertainment expenses. Don't rule out taking a deduction for the cost of entertaining a client or customer at a social club just because you can't deduct the club dues. For example, if you meet with a client at your country club to talk business and then have dinner, half the cost of the dinner is potentially deductible as a business expense. To claim the deduction, you should have appropriate records.

Travel. The entire cost of airfare or other transportation to and from a destination within the U.S. is deductible if the primary reason for a trip is business related. To secure the full deduction, you need to be able to show the number of days you spent on business was larger than the number of personal days.



Business days include the days you spend traveling to and from the place where you conduct business activities, as well as weekends and holidays that fall between





business days if returning home would be impractical.

Example

On Wednesday, Todd flies cross-country to attend business meetings on Thursday, Friday, and the following Monday. Todd takes the weekend off to relax and do some sightseeing and flies home on Monday night. His entire hotel stay is a deductible business expense, since it would have been impractical for him to fly home for the weekend. He also may deduct his round-trip airfare and 50% of his business meals.

Automobiles. Tax deductions for business-related driving generally may be figured using actual expenses (for fuel, repairs, insurance, etc.) or a standard mileage rate provided by the IRS. The standard mileage rate may be used whether a car is leased or owned. Use of the standard mileage rate simplifies recordkeeping but won't necessarily produce the largest deduction.

When using the standard mileage rate, be sure to keep track of parking fees and tolls. They represent an additional deduction.

If you are self-employed and take a car loan to buy a vehicle for use in your business, the loan interest is deductible to the extent of business use. An employee's auto loan interest is nondeductible even if the car is used for business.

Self-employed health insurance. Because an individual's itemized deduction for unreimbursed medical expenses is limited by the 7.5%-of-AGI floor, you should consider obtaining health insurance for yourself and your family through your business. As a self-employed sole proprietor, an S corporation shareholder/employee, or a partner, you could deduct 100% of your cost directly from your AGI, assuming you met all requirements.





Hiring your child. Reasonable wages paid to your child for bona fide services are deductible against your business income. In addition to income-tax savings, employing your child can result in savings on self-employment taxes if you are self-employed. Until your child reaches age 18, there won't be a liability for FICA (Social Security and Medicare) tax with respect to the wages you pay your child. As for your child's income taxes, the standard deduction is available to offset up to \$5,700 of your child's earnings in 2009.





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ASSET PURCHASES

Your annual business tax planning should include a depreciation review. The timing of purchases and the depreciation periods and methods used to write off the cost of newly acquired or constructed assets can have a significant impact on your business taxes.

Categorizing costs. If you plan to buy or construct a new business facility, pay close attention to the way costs are classified. While commercial buildings and their structural components are generally depreciable over 39 years, depreciation periods are typically much shorter for equipment, furniture, fixtures, and other assets classified as tangible personal property.

Timing. The tax law generally allows a deduction for a half-year's worth of depreciation in the first year. (Real estate is an exception.) However, if a business places more than 40% of non-real-estate assets acquired during the year in service during the last three months of the tax year, the depreciation calculation is based on a "mid-quarter convention." This produces a larger deduction on assets acquired earlier in the year and a smaller deduction on those acquired later.



Section 179 expensing. Instead of depreciating newly





acquired non-real-estate assets, you may make a special election under Section 179 of the tax code to expense the purchase in the current year. The maximum amount that can qualify for the election in 2009 is \$133,000. The deduction is limited to the amount of your taxable income from active trades or businesses and is phased out as purchases of qualifying assets rise from \$530,000 to \$663,000.

If you own interests in several businesses, monitor the Section 179 limit carefully. It applies per taxpayer return. As a result, any Section 179 deductions allocated to you from partnerships, S corporations, and LLCs will be added to the purchases you elect to expense as a sole proprietor in applying the dollar limit.

**Depreciation Under the
Modified Accelerated Cost Recovery System**

| Property Class | Assets Included* |
|---|--|
| 3-year | Tractor units for over-the-road use |
| 5-year | Automobiles, trucks, computers, copiers and other office machinery |
| 7-year | Office furniture and fixtures |
| 10-year | Vessels, barges, tugs |
| 15-year | Certain land improvements |
| 20-year | Farm buildings (other than certain single-purpose structures) |
| 25-year | Water utility property |
| Residential rental property (27.5-year) | Apartment buildings, single-family rental properties |
| Nonresidential real property (39-year) | Office buildings, stores, warehouses |

** The lists of property included in each class are not all-inclusive.*





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TAX-FAVORED BENEFIT STRATEGIES

Health insurance. If your company offers health benefits, you may be able to reduce your employees' costs — and your company's payroll taxes — with a cafeteria plan arrangement that allows employees to pay their share of the insurance premiums through pretax payroll deduction.

Example

In 2009, Acme's employees contribute \$375,000 for their company-provided health insurance coverage. Because the coverage is offered through a cafeteria plan, the company deducts the premiums from the employees' gross pay before calculating withholding amounts for federal income taxes and FICA taxes. The resulting tax savings defray some of the cost of the insurance. Acme also saves its share of the FICA taxes on the \$375,000.

A cafeteria plan can include a flexible spending arrangement that allows employees to set aside money from their paychecks pretax for their other out-of-pocket medical costs, such as doctor-visit copays.

Health savings accounts and health reimbursement arrangements are other tax-favored options for health benefits that you might consider.

Retirement plans. Business owners and their employees can gain significant tax advantages by participating in a company-sponsored retirement plan. Contributions to a qualified retirement plan for yourself and any eligible employees are tax deductible, within tax law limits. And plan participants (including you) can defer paying income taxes until distributions are received from the plan.





Profit sharing plans are very flexible, since decisions about whether to make a contribution in a given year and the contribution amount can be left to the company's discretion. If desired, the plan can have a 401(k) salary deferral feature.

401(k) plans allow participating employees to save a percentage of their pay on a pretax basis. The sponsoring employer may make matching contributions but isn't required to do so. In addition to pretax contributions, a 401(k) plan may offer a Roth contribution option.

Defined benefit plans provide benefits in the form of a traditional pension. Although this type of plan is less popular now than in the past, it can be ideal for older owners who desire faster accumulation of benefits.

Simplified Employee Pension (SEP) plans are funded with tax deductible contributions made by the employer. The contributions go into IRAs for the participants. (SEP plans established before 1997 may allow employees to contribute.)

SIMPLE plans give eligible employees the opportunity to make payroll contributions on a pretax basis. The employer is required to contribute to the plan annually. Like SEP plans, SIMPLE plans are relatively easy to establish and maintain.



Transportation fringe benefits. Certain commuting-related benefits do not have to be included in employees' taxable income. You can offer the benefits either as "extra" compensation or as an optional benefit that employees pay for themselves through pretax salary reduction. The benefits that qualify for favorable tax treatment include parking, transit passes, and commuter transportation in a van pool that meets tax law requirements. (Dollar limits apply.) Starting in





2009, employees who ride bicycles to work may be reimbursed for expenses of up to \$20 a month. This benefit can't be funded through pretax salary deferral.

Other tax-free benefits. Qualified retirement planning services, qualified employee discounts, educational assistance of up to \$5,250, and on-premises athletic facilities are some of the other valuable fringe benefits that your company might consider offering.





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Now that you've read this *Tax Planning Guide*, we encourage you to talk with us. We can help you review your specific situation and answer any questions you may have about how the planning ideas presented may apply to you.

We'd be happy to give you more information about the broad range of services we offer. Please contact us soon.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

