



ANAHEIM  
2009

The Annual Conference of the Financial Planning Community

<b>TRACK:</b>	<b>TAX &amp; ESTATE PLANNING</b>
<b>SESSION: 979017</b>	<b>2009 FEDERAL TAX UPDATE</b>
	SUNDAY, OCTOBER 11, 2009
	8:15 AM - 9:30 AM
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John Kilroy is a Senior Wealth Planner for Vanguard Asset Management Services. In addition John maintains a sole proprietor tax and accounting practice in the Philadelphia, Pennsylvania area, specializing in tax planning and preparation for individuals, corporations, partnerships, estates and trusts. John is a CPA and holds the CFP® designation and maintains NASD licenses 7, 24, and 66. He is a 1979 graduate of Villanova University with a BS in Accounting. John is a member of the Pennsylvania Institute of Certified Public Accountants and the Financial Planning Association (FPA). Within the FPA John serves as a Board Member of the Philadelphia Tri-State chapter and on its education committee, while also serving on the FPA Major Firms Task Force. John is as an adjunct faculty member for the American College CFP® program for Vanguard CFP® candidates and is a frequent speaker and facilitator on tax and financial planning topics throughout Vanguard. John has spoken at Vanguard sponsored seminars and client meetings, as well as FPA local chapter meetings. John has been quoted in the Wall Street Journal and on MarketWatch.com. John has also discussed financial and tax planning issues on Federal News Radio.

# Federal Tax Update

FPA Anaheim  
John Kilroy CPA, CFP®  
October 11, 2009

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## Agenda

- What's New
- Planning opportunities
  - 2009 through 2011
- What may be Next

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## What's New

- American Recovery and Reinvestment Act (ARRA) of 2009 (Recovery Act)
  - Otherwise known as the Stimulus Bill
- Other 2009, 2010, 2011 issues

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## ARRA 2009

- Individual taxpayer provisions
  - Core of the Act
  - Generally aimed at middle class
- Business taxpayer provisions
  - Limited portion of the Act
  - Change from other recent legislation

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## ARRA 2009 - Individuals

- Making Work Pay Credit
  - 2009-10 refundable credit
  - \$800 (MFJ) maximum (\$400 other filers)
  - Essentially OASDI (6.2%) of first \$6450 earned income
  - Phases out at \$150,000 to \$190,000 MAGI (MFJ)
    - 1/2 phase out range other filers
  - Typically through W4 withholding adjustment
    - Watch out – prepare income tax projection

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## ARRA 2009 - Individuals

- Economic Recovery Payment
  - \$250 payment to SS, RR, SSI, Government Disability payees
    - One Time
    - Typically paid early summer 2009
    - Will reduce Making Work Pay Credit
  - Also available to Government retirees not eligible for SS
    - Refundable
    - Up to \$500 if both spouses qualify

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### **ARRA 2009 - Individuals**

- American Opportunity Education Credit
  - Replaces HOPE Credit for 2009-10
  - Covers eligible expenses (tuition, student materials) for four years of college per student
  - \$100% of first \$2,000 and 25% of next \$2,000
  - 40% refundable
    - Unless taken by someone subject to Kiddie Tax
  - Phaseout \$160,000 - \$180,000 MFJ
- Lifetime Learning Credit; Above the Line Deduction still in play

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### **ARRA 2009 - Individuals**

- First Time Homebuyer Credit revision
  - Prior law viewed as unattractive because of its “interest free loan” status (payback requirement)
    - Payback still required for pre 1/1/09 purchase
  - Principal residence purchased 1/1/09 to 11/30/09
    - Credit increased to \$8,000 maximum (\$4,000 MFS)
    - No payback unless house sold within three years
      - Or otherwise is no longer principal residence
    - Planning Tip: can elect credit on 2008 or 2009 return
  - No home ownership within prior three years

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### **ARRA 2009 - Individuals**

- AMT Provisions
  - AMT exemption “patched” for 2009
  - \$70,950 MFJ; \$46,700 unmarried; \$35,475 MFS
    - Expected to limit AMT payers to 3-4 million
  - Laundry list of non-refundable tax credits taken against regular tax and AMT extended through 2009

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### **ARRA 2009 - Individuals**

- Residential Energy Credit Provisions
  - Revised for 2009 and extended through 2010
    - Prior law allowed for 2006, 2007, and 2009
  - Eligible building envelope components
    - Insulation, windows, doors, heat pumps, AC, water heaters, boilers, stoves, etc.
    - 30% of cost
    - \$1,500 aggregate limit
- Other Credits (Solar; Vehicle)

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### **ARRA 2009 - Individuals**

- Sales tax deduction for qualified motor vehicle
  - Purchased after 2/16/09 through 12/31/09
    - Taxpayer original owner
  - Less than 8,500 pounds or motor home
  - Sales tax on up to \$49,500 per vehicle
  - Fast phase out (\$250,000 - \$260,000 MAGI MFJ)
  - Itemized or Standard
  - IR 2009-60 – deduction allowed in non-sales tax states

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### **ARRA 2009 - Individuals**

- Other Provisions
  - Computer and related expenses allowed from Section 529 Plans
  - Increased Earned Income Credit
  - Increased Refundable portion of Child Tax Credit
  - Private Activity Bonds issued in 2009-10 not subject to AMT add back
  - Tax Credit Bonds for Schools
  - Build America Bonds
  - Partial (\$2,400) of unemployment benefits excluded in 2009

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### **ARRA 2009 - Business**

- NOL Carryback Period extended
  - Now 3, 4 or 5 years for NOL incurred in 2008
  - Small Business – revenue less than \$15 million average over last three years
  - Hurry – deadline is October 15, 2009 to establish carryback
    - If applicable return extended
    - Form 1045 (individuals); 1139 (C Corporations)

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### **ARRA 2009 - Business**

- COBRA assistance
  - Splits cost to 65% government and 35% individual
  - Involuntary termination between 9/1/08 and 12/31/09
  - Employer recovers through payroll tax filings and other compliance requirements
  - Eligibility phase out (\$250,000 - \$290,000 MAGI MFJ)

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### **ARRA 2009 - Business**

- Depreciation/Expensing
  - Bonus depreciation (50% first year) extended through 2009
  - Section 179 limit \$250,000 extended through 2009
    - \$800,000 cap on eligible property
- Cancellation of Debt through reacquisition
  - Defers income recognition (2009 – 5 yrs; 2010 – 4 years)
  - Ratable recognition after deferral period (20% per yr.)

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### Planning Opportunities

- One of the lowest marginal and capital gain rates in our history
  - Only 1984 lower
  - How long will it last?
- 0% LTCG and QDI rate through 2010
- Sunset – automatic tax increase in 2011
- AGI is still catalyst for most tax features
- Tax planning is very often not done

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### Planning Opportunities

- 2009 Suspension of Required Minimum Distribution
  - Applies to all plan types except Defined Benefit
    - Owner or beneficiary (if over 70 1/2)
  - Do not associate net worth to AGI (MAGI) or taxable income
  - Could significantly lower tax bracket
    - Possibly negative taxable income

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### Planning Opportunities

- 2009 Suspension of Required Minimum Distribution (or other circumstances)
  - Opens door for:
    - Roth conversion and/or IRA distribution
    - Taxable Annuity distribution
    - Taxable/Tax-Exempt bond/money market moves
    - Zero percent capital gain/QDI
    - Itemized deduction timing and location
    - AMT planning

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## Planning Opportunities

- Roth conversion
  - \$100,000 MAGI limit/MFS exclusion in 2009
  - No limits or exclusions in 2010 or after
  - How much?
    - Perhaps up to current tax bracket or next tax bracket
    - At least eliminate any negative taxable income
    - Consider cash flow and ability to pay tax outside of conversion
  - Investigate Roth IRA/Roth 401(k)/Roth 403(b) eligibility

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## Planning Opportunities

- Roth conversion
  - From IRA or qualified plan
  - Be careful
    - SIMPLE plan – only after 2 years
    - After-tax contributions in conversion
      - IRA – pro rata
      - Qualified plan - ?
  - 2010 conversion – *income* split between 2011 and 2012
    - Sounds too good to be true?

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## Planning Opportunities

- Taxable Annuity Distribution
  - Non periodic withdrawal
    - Earnings first if contract issued after 8/13/82
    - Tax efficiency of portfolio
    - May lower cost of asset
  - Watch for relationship between contract value and death benefit
  - Estate planning/IRD asset

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## Planning Opportunities

- Taxable/Tax-Exempt bonds/money markets
  - Coordination with tax bracket of investor
    - Often mismatched
      - Why would 35% MTB taxpayer have \$200,000 + in taxable bond income?
  - Capital gain/loss of repositioning
    - Capital loss carryover or harvesting opportunity?
  - State taxation
    - State solvency?

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## Planning Opportunities

- Zero percent LTCG/QDI
  - Layering of *net* ordinary income first
    - Wages, interest, non QDI, STCG, other income less itemized or standard deduction and personal exemptions
  - Then LTCG/QDI
    - Taxed at 0% up to top of 15% marginal tax bracket
      - Regular tax and AMT
    - Taxed at 15% beginning in 25% marginal tax bracket
      - Watch out for AMT effect

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## Planning Opportunities

- Itemized deduction timing and location
  - Timing of expense
    - Deductible or not (regular or AMT)
    - Floors and phase outs
    - Control over when paid
  - Location
    - Can expense be moved “above the line”?
      - Home office
      - Rental or business activity
      - Added to cost basis

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## Planning Opportunities

- AMT Planning
  - Begins with good tax planning (AGI)
  - Pay particular attention to AMT exemption
    - Phase out of exemption creates phantom income
      - AMT marginal rates will increase from 26% or 28% to 32.5% or 35% in phase out range
      - \$1 of exemption phase out for every \$4 of income
      - LTCG and/or QDI effective rate increases from 15% to up to 22% in phase out range
      - Get off the AMT phase out island if possible
  - Make AMT an Alternative Maximum Tax
    - Income space after exemption phase out – 28% AMT rate vs. 35% ordinary income rate

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## Planning Opportunities

- Cancellation of Debt on Primary Residence
  - Up to \$2 million (\$1 million MFS) on Acquisition debt
  - Through 2012
  - Basis Reduction
    - Not below zero
  - Due to either
    - Value of residence decline
    - Financial condition of owner
  - Mortgage restructuring or foreclosure

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## What May Be Next?

- Health Care
  - Percentage surtax on taxpayers above MAGI limits
    - Could increase marginal rates substantially if combined with other rate increases (2010 sunset of highest rates)
  - Employer excise payroll tax if not offering health insurance
    - Employee tax if also not securing coverage
  - Small business tax incentive to offer health insurance
  - Limiting or eliminating tax deductions for medical expenses
  - Eliminating Health FSA and/or HRA exclusions

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### What May Be Next?

- Estate Tax
  - Extension or “patch” of current exemption and rate
  - Reunify gift and estate exemption
    - Currently gift is \$1 million and estate is \$3.5 million
  - Create portability of estate exemption between spouses
    - Would save cost of most tax related estate planning
  - Change rates

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### What May Be Next?

- Budget Proposals – Individuals
- Over \$250,000 (\$200,000 single) MAGI
  - Reinstate the 36% and 39.6% marginal rates (2011)
  - Raise LTCG and QDI rate to 20% (2010)
  - Reinstate phase out of personal exemptions and itemized deductions (2011)
  - Maximize rate of certain itemized deductions to 28%
- Make certain tax credits “permanent”
- Automatic IRAs

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### What May Be Next?

- Budget Proposals – Business
- Expand NOL carryback (2011)
- Eliminate capital gain on sale of small businesses (2014)
- Repeal LIFO (2012)
- Tax carried interest as ordinary income (2011)
- Require information reporting for rental payments (2010)
- Repeal Oil and Gas tax breaks (2011)

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