



Client Newsletter

Tax Planning Updates

September 14, 2010

As summer comes to an end and the closing months of 2010 are now upon us, we thought it would be helpful to share some planning updates and reminders. Please click on an area of interest or scroll through all of them.

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Uncertainty on Taxes

Congress is currently in a logjam over taxes that is not likely to be resolved before the elections in November. It appears that progress on more important tax provisions will not occur until a lame duck session of Congress. This would include what to do with the Bush tax cuts, extending lapsed provisions from 2009 (such as IRA charitable distributions) and the ongoing debate surrounding the perennially pesky alternative minimum tax.

Politics are at the center of this impasse and all parties will no doubt be using this as a point of debate.

Potential Consequences of Postponing Decisions

Obviously, delaying until a lame duck session will create a compressed period of time in which to reach agreement. One potential outcome is a short-term extension of the Bush tax cuts for everyone. This would include keeping the current tax brackets in place and keeping the top tax rate on long term capital gains and qualified dividends capped at 15%. This may end up being the "easiest" solution – it is at least some action that keeps the status quo. More permanent fixes could then be taken up in 2011.

Another solution is that limited or no action is taken before the next Congress is seated. This would allow the Bush tax cuts to expire, increasing capital gain rates to 20%, top ordinary rates to 39.6% and dividends would be taxed at ordinary income rates. This result could be fairly destructive to a struggling economy, which is why most commentators believe it will not happen. While the chances of this outcome may seem low, we bring your attention to the next section for perspective.

Estate Tax Update

For nearly a decade, the estate tax system has been evolving with increased exemption amounts, followed by no estate tax in 2010, to then be followed by a return to the estate tax as it existed at the beginning of the decade. Countless presenters at estate planning conferences across the country have said over this time that certainly Congress would deal with the “disappearing” estate tax before 2010 arrived.

Well, 2010 arrived and is mostly gone, with no change to this law, which has made/is making planning difficult. Much discussion has ensued this year as to whether Congress could pass legislation during the year and apply it retroactively to January 1. Issues of fairness and constitutionality have added to the normal election cycle difficulties in passing legislation. So, it looks like there will not be an estate tax for 2010.

Therefore, heirs will need to understand the carryover basis rules in effect this year. For 2010 estates, heirs will start with the decedent’s basis for an asset they inherit (hopefully, there are good records for cost basis). Basis can then be increased by \$1.3 million, plus any unused loss carry-forwards of the decedent and the amount of unrealized loss on the asset. Therefore, heirs of estates with \$1.3 million or less of untaxed capital gain will still use the date of death value to determine their new cost basis. The executor can choose which assets get the cost basis increase, so caution is needed in planning how to do this equitably when assets are not left equally to heirs.

An additional \$3 million can be used to increase the basis of assets that pass to a surviving spouse, for a total basis increase of at least \$4.3 million. In any circumstance, the basis allocation to an asset cannot increase the basis over the asset’s value.

Given these rules for 2010, larger estates may still face tax issues, even without an estate tax. However, the capital gains tax is far less than the estate tax and the timing of the capital gains tax can be controlled by when an inherited asset is actually sold.

Roth Conversions

For those who did Roth conversions in 2009, you have until Oct. 15, 2010 to undo the switch. Re-characterizing back to a traditional IRA will wipe out the tax on the conversion and may make sense if the balance of the Roth IRA has fallen since converting. If your 2009 tax return has been filed, an amended return can be filed to recover the tax. After 30 days, you can then re-convert back to a Roth IRA. For amounts converted or re-converted in 2010, you will have the option of including the taxable amount in 2010 income or spreading it equally over 2011 and 2012.

Inherited IRA's

If you inherited an IRA in 2009, you have until September 30, 2010 to make sure the beneficiaries are clearly identified. If there are any non-individual beneficiaries, such as a charity, those beneficiaries should be paid by September 30 to afford any individual beneficiaries the greatest flexibility in taking their share. Also remember if you want to take required distributions over your lifetime you will need to begin distributions by December 31, 2010.

We hope this update is useful as you enter into your year-end planning. Please let us know if you have questions about these or other issues.

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