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Happy holidays! As in prior years, I prepared a tax letter that I hope will help you with tax planning and make you aware of recent changes. There are many more tax changes than I have included in this tax letter. I focused on those that are most likely to affect you. While many of the items in the Tax Highlights and Planning Strategies (pages 3-8) are similar to prior years, I wanted to emphasize the following:

- 1) If your taxable income (income after deductions) is below \$34,000 (\$68,000 if married), you should consider either a Roth conversion or realizing long-term capital gains as a way to report higher income in 2009 without paying much (or in some cases any) additional tax (see item 7d under Investment Strategies on page 6).
- 2) In the past, taxpayers with income over \$100,000 were not eligible to do Roth conversions, but under a federal law passed in 2006, starting January 1<sup>st</sup> the \$100,000 income limit is eliminated so anyone can convert a Traditional IRA into a Roth IRA. If you have been making nondeductible contributions to a Traditional IRA and your "basis" (the cumulative nondeductible contributions) comprises a large portion of your total IRAs (including SEP and SIMPLE IRAs, but excluding any Roth IRAs), you are an ideal candidate for a Roth conversion because only the pre-tax portion of your IRAs (any earnings and pre-tax/deductible contributions) will be taxed at conversion. If you are interested in a Roth conversion and want to talk through the pros and cons, give me a call. Note that Wisconsin has not yet adopted this law, and if the state decides against its adoption, Wisconsin residents with income over \$100,000 in 2009 will need to recharacterize Roth conversions back into Traditional IRAs to avoid excess contribution and early distribution penalties.
- 3) More taxpayers who pay college tuition (or to other accredited post-secondary education institutions) will qualify for a tuition credit (the new American Opportunities Credit - essentially an expanded Hope Credit) because the income phase-out has been raised (now married couples with income of up to \$180,000 qualify). Also, up to \$1,000 of the credit is now "refundable," helping taxpayers with lower income receive a tax benefit (previously, the credit could only reduce your tax to zero). This makes it even more important than in prior years to decide which tax year is best for paying tuition. For example, if you have already paid more than \$4,000 of tuition for a student in 2009 (enough to qualify for the maximum American Opportunities Credit), and the spring semester is your last semester, then delay paying the spring 2010 tuition until January so you can claim the credit in 2010. See further discussion under Tuition on page 6).
- 4) If your Medicare Part B premiums have been significantly increased for 2010 (based on income you reported on your 2008 tax return) and you have had a "life-changing event," you can appeal your Medicare premium. See page 4, Medicare Part B Premiums, for further discussion.

### **New Federal Tax Law**

December 2008 - Worker, Retiree, and Employer Recovery Act of 2008:

- Required Minimum Distributions from qualified requirement accounts were waived for 2009

February 2009 - American Recovery and Reinvestment Act of 2009:

- Making Work Pay Credit – for 2009 and 2010, provides a credit equal to 6.2% of earned income, up to a maximum \$400 (\$800 joint filers); phased-out for income \$75k-\$95k (\$150k-\$190k joint filers); payroll withholding tables were adjusted to reduce withholdings; taxpayers must file Schedule M with their 2009 and 2010 tax returns to determine their credit, and their refund or tax due will be affected depending on whether withholdings were reduced too little or too much
- \$250 Economic Recovery Payment – one-time payment in 2009 to individuals on fixed incomes from the Social Security Administration, Railroad Retirement Board and Department of Veterans Affairs; retired government workers who are not eligible for Social Security also can claim the \$250 by filing a 2009 tax return; note that the \$250 reduces any Making Work Pay Credit (see above)
- Unemployment benefits of \$2,400 excluded from federal tax in 2009

- COBRA medical premiums subsidized up to 65% for a maximum of 9 months for individuals terminated from employment from 9/1/08 - 12/31/09 (note that the “subsidy” starts phasing-out for income > \$125k (\$250k joint returns) and is eliminated for income > \$145k (\$290k joint returns); individuals are required to “recapture” the unallowed amount on their tax return as income)
- Deductions (standard or itemized) increased for sales tax paid to purchase a new vehicle 2/17/09-12/31/09 (on up to \$49,500 purchase price per vehicle; phase-out for income \$125k-\$135k (\$250k-\$260k joint returns); note this does not reduce federal tax for people who pay AMT)
- American Opportunity Tax Credit (see Tuition, item 9a on page 6)
- First-Time Homebuyer Credit changed to a maximum \$8,000 and not repaid (unlike the year 2008 credit which was required to be repaid over 15 years); for homes purchased 1/1/09 – 11/30/09 by individuals who did not own a primary residence during the 3 years prior to the date of purchase, and phased-out for taxpayers with income between \$75k-\$95k (\$150k-\$170k joint returns)
- Residential Energy Property Credit - 30% of the cost (subject to a total limit of \$1,500 for the two years 2009 & 2010) of energy-efficient improvements for your primary residence; other credits for solar, geothermal and wind energy property, and alternative fuel and plug-in electric vehicles
- AMT - for 2009 the higher exemption was reinstated and certain credits can be used to offset AMT
- 529 plan - tax-free withdrawals for computer equipment, software and internet access if used by the beneficiary during years they are enrolled at a post-secondary school (for 2009 & 2010)
- Numerous businesses tax breaks, including extension of the higher Section 179 expense limit and 50% first-year bonus depreciation to 2009, and expanded net operating loss carrybacks

#### November 2009 - Worker, Homeownership, and Business Assistance Act of 2009:

- First-Time Homebuyer Credit expanded to homes purchased through 4/30/09 (plus any binding contracts entered into by 4/30/10 which close by 6/30/10); new \$6,500 credit for homebuyers who have owned and used the same residence for any 5-year period (during the last 8 years); no credit is allowed for homes that cost more than \$800,000 (applies for purchases after 11/6/09); income phase-out increased to \$125k-\$145k (\$225k-\$245k joint returns)
- Unemployment benefits extended for up to 14 weeks (with 6 additional weeks for individuals in states with higher unemployment, including Wisconsin); applies for those who have exhausted their federal aid or will do so by 12/31/09
- Additional expansion of net operating loss carrybacks for businesses

#### 2010 and beyond:

- Many tax laws expire after 2010, including reductions in ordinary and capital gains tax rates, the special tax rate for qualified dividends, various “marriage penalty” relief provisions, numerous deductions, and estate tax changes. I would expect 2010 to be a very busy year for new tax laws.

### **New Wisconsin Tax Law**

- Beginning in 2009, Wisconsin excludes from income the first \$5,000 of IRA or retirement plan withdrawals for retirees age 65 or older if their income is below \$15,000 (\$30,000 for joint returns).
- Due to budget constraints, the state has delayed several new subtractions from income until 2011 (previously scheduled to start in 2009). This includes a new subtraction for child and dependent care expenses (the same expenses as used for the federal credit) and an increased subtraction for health insurance paid with after-tax dollars.
- The state has not adopted portions of a 2006 federal law that impacts retirement plans and IRAs (including allowing the current limits for IRA, 401(k), 403(b) and other retirement accounts beyond year 2010, and allowing Roth conversions for taxpayers whose income exceeds \$100,000 starting in January 2010). The legislature is expected to debate these provisions in 2010.
- The state increased the top tax rate to 7.75% (from 6.75%). This rate applies to income > \$225k for single, head of household and fiduciary taxpayers (and >\$300k for married taxpayers). Because the increase was enacted in July 2009 but is retroactive to the start of 2009, the state will not levy an underpayment penalty on the extra tax due with tax returns in 2009 because of the tax increase.
- The state also changed the tax on long-term capital gains in July 2009, retroactive to the start of 2009. Prior to 2009, the state excluded 60% of long-term capital gains from tax, but now only 30% of long-term capital gains are excluded from tax.

## Tax Highlights for Individuals

**Rates:** Tax rates remain the same except for increases in income levels for inflation, as shown below:

Federal Tax Rate***	10%*	15%*	25%**	28%**	33%**	35%**
<b>2009 Taxable Income:</b>						
Single	\$0-\$ 8,350	\$ 8,351-\$33,950	\$33,951-\$ 82,250	\$ 82,251-\$171,550	\$171,551-\$372,950	>\$372,950
Head of Household	\$0-\$11,950	\$11,951-\$45,500	\$45,501-\$117,450	\$117,451-\$190,200	\$190,201-\$372,950	>\$372,950
Married	\$0-\$16,700	\$16,701-\$67,900	\$67,901-\$137,050	\$137,051-\$208,850	\$208,851-\$372,950	>\$372,950
<b>2010 Taxable Income:</b>						
Single	\$0-\$ 8,375	\$ 8,376-\$34,000	\$34,001-\$ 82,400	\$ 82,401-\$171,850	\$171,851-\$373,650	>\$373,650
Head of Household	\$0-\$11,950	\$11,951-\$45,550	\$45,551-\$117,650	\$117,651-\$190,550	\$190,551-\$373,650	>\$373,650
Married	\$0-\$16,750	\$16,751-\$68,000	\$68,001-\$137,300	\$137,301-\$209,250	\$209,251-\$373,650	>\$373,650

\* Except 0% rate on qualified dividends and long-term capital gains (for 2008 – 2010)  
 \*\* Except 15% rate on qualified dividends and long-term capital gains  
 \*\*\* Rates expire at the end of 2010. Starting 2011 (under current law), the 10% rate is eliminated, 25% reverts to 28%, 28% reverts to 31%, 33% reverts to 36%, and 35% reverts to 39.6%; long-term capital gains rates revert to 10% and 20% (versus the current 0% and 15%), and there is no special rate for qualified dividends (i.e. would be taxed as ordinary income)

**Personal Exemption:** \$3,650 subtraction from income for yourself and each dependent (same for 2010). For 2009, up to 1/3 of the exemption phases-out (once income exceeds \$166,800 (single), \$208,500 (head of household) and \$250,200 (married)). The phase-out is eliminated for 2010.

*Note: personal exemptions do not reduce your total federal tax if you are paying AMT.*

**Standard or Itemized Deduction:** You are allowed to subtract from taxable income the higher of your standard deduction or itemized deductions (primarily state income taxes, real estate taxes, mortgage interest and charitable donations). A portion of your itemized deductions are phased-out once income exceeds \$166,800 (this is eliminated in 2010). The standard deductions are as follows:

	<u>Married</u>	<u>Head of Household</u>	<u>Single</u>	<u>Extra for Age 65+ or Blind</u>	<u>Dependent</u>
2009	\$11,400	\$8,350	\$5,700	\$1,100 married; \$1,400 single	\$950
2010	\$11,400	\$8,400	\$5,700	\$1,100 married; \$1,400 single	\$950

For 2009, the standard deduction is increased by the following:

- + \$500 (single) or + \$1,000 (married) for real estate taxes paid during the year
- + sales tax paid on purchase of a new vehicle (see restrictions listed on page 2)
- + property loss in Midwest disaster (not compensated by insurance or otherwise)

**Child Tax Credit:** The child tax credit remains \$1,000 per qualifying child under age 17. The credit is gradually phased-out once income exceeds \$110,000 (\$75,000 if single or head of household) at a rate of \$50 per \$1,000 of extra income (e.g. for a married couple with two children, the \$2,000 total credit is lost once income exceeds \$150,000).

### Income Earned by Children:

- a) If the child is a dependent, the following thresholds apply for 2009 and 2010:
  - No tax on first \$950 of investment income; tax at child's rate for the next \$950 of investment income; tax at parent's tax rate for any additional investment income (see Kiddie Tax below)
  - If the child has wages, up to \$5,700 of income may be tax-free (wages + up to \$300 of investment income, not to exceed \$5,700 total)
- b) Kiddie Tax:

The portion of investment income (interest, dividends, capital gains, rental income, IRA distributions, etc.) **that exceeds \$1,900** is taxed at the **parent's marginal tax rate** if one of the following applies:

- 1) Child is under age 18
- 2) Child is 18 at year-end (or 19-23 and a full-time student) and didn't have earned income (wages) providing greater than 50% of their own support

*Caution – a child who is not a dependent can still be subject to the Kiddie Tax. An example is a child who is 18 (or a 19-23 year old student) who provides >50% of their own support from investment income (not wages).*

<b>Mileage Rates:</b>	<u>Business</u>	<u>Medical &amp; Moving</u>	<u>Charitable</u>
2009	55¢	24¢	14¢
2010	50¢	16.5¢	14¢

**Social Security:** No change in Social Security (6.2%) and Medicare (1.45%) tax rates. The rate for self-employed persons remains 15.3% (i.e. (6.2% + 1.45%) x 2). Social Security taxes are paid on the first \$106,800 of earnings in 2009 (same in 2010). If you are already collecting Social Security, the federally taxable portion of your Social Security benefits depends on the level of your other income (up to 85% may be federally taxable). Wisconsin no longer taxes Social Security benefits. Social Security benefits will not be increased for 2010 because the Consumer Price Index dropped. If you are collecting Social Security benefits and have not yet reached your full retirement age, in the years before you reach your full retirement age you can earn a small amount of wages or self-employment income (up to \$14,160 for the year 2009; same for 2010) and still collect your full Social Security (above this level of earnings, SSA will reduce your benefits by \$1 or every \$2 by which you exceed the limit). In the year you reach your full retirement age, the income limit only applies for the months before you reach your full retirement age, the limit is much higher (\$3,140 per month for 2009, same for 2010), and your benefit is only reduced by \$1 for every \$3 by which you exceed the monthly limit.

**Medicare Part B Premiums:** The monthly premiums for Medicare Part B are shown below. Note that premiums will not increase for individuals in the lowest income bracket.

Monthly Premium		Modified Adjusted Gross Income***		
2009	2010	Single*	Married Filing Jointly	Married Filing Separate
\$ 96.40	\$ 96.40**	\$ 85,000 or less	\$170,000 or less	\$85,000 or less
134.90	154.70	\$ 85,001-\$107,000	\$170,001-\$214,000	N/A
192.70	221.00	\$107,001-\$160,000	\$214,001-\$320,000	N/A
250.50	287.30	\$160,001-\$214,000	\$320,001-\$428,000	\$85,001-\$129,000
308.30	353.60	Above \$214,000****	Above \$428,000****	Above \$129,000

\* Also includes Head of Household, Qualified Widow/Widower with dependent child, and Married Filing Separate if you lived apart all year.  
 \*\* 2010 premium is \$96.40 if the premium is deducted from your Social Security check and you started Medicare before 2010. All others (those paying for Medicare directly or who started Medicare in 2010) will be paying \$110.50 per month instead.  
 \*\*\* 2009 premium is based on Adjusted Gross Income plus tax-exempt interest reported on your 2007 tax return. The 2010 premium is based on your 2008 tax return. If your return was filed late, then a one year earlier tax return was used instead.  
 \*\*\*\* The above income brackets are used to determine the 2010 premium. Amounts for determining the 2009 premium were the same, except for the highest income brackets, which were \$213,000, \$426,000 and \$128,000.

Keep in mind that if you reported an unusually large amount of income in 2008 (for example, because of a gain on the sale of an asset or a large withdrawal from an IRA), you will be paying a higher Medicare premium during 2010 (the premium year based on your 2008 taxable income), but then your premium will drop back down in 2011 (based on lower income reported on your 2009 tax return). If however, you have had a “life-changing event” that has substantially reduced your income, you may appeal the higher premium by completing form SSA-44 (found online at [www.ssa.gov/online/ssa-44.pdf](http://www.ssa.gov/online/ssa-44.pdf)) or by calling 800-772-1213 to schedule an interview at a local Social Security office. You can provide an estimate of your 2009 income and request that the government use the estimate instead of your 2008 tax return if you experienced a reduction in your income in 2009 due to a life-changing event that occurred in 2009 or an earlier year. Life-changing events include marriage, divorce, death of a spouse, work stoppage or reduction, loss of income from income-producing property (not due to sale of a property, but for example due to a natural disaster), and loss of pension income (due to plan termination or change in benefits).

## **Planning Strategies**

- 1) Itemized Deductions:** To increase your itemized deductions, consider the following:
- You can deduct up to 13 months of mortgage interest. Consider making your January mortgage payment early (by December 31<sup>st</sup>). Be sure your payment reaches your lender before December 31<sup>st</sup> and that they include the interest on Form 1098 for 2009.
  - Pay your real estate taxes by December 31<sup>st</sup>. If you are “bunching” your itemized deductions into every other year and 2009 is the year when you will NOT itemize, consider paying the first \$500 of your real estate taxes (\$1,000 for married taxpayers) so that your standard deduction is increased by this amount and you can claim a state property tax credit.  
*Note: Paying property taxes does not reduce your federal tax if you are subject to AMT, but there is still a state benefit - the first \$2,500 paid each year gives you a \$300 Wisconsin tax credit.*
  - If you pay estimated taxes quarterly, pay your 4<sup>th</sup> quarter state amount (due January 15<sup>th</sup>) by December 31<sup>st</sup>. *Note: Does not help reduce federal tax if you are in AMT.*

- 2) **Alternative Minimum Tax:** Not much has changed from 2008. If you paid AMT in 2008 and your 2009 income and deductions are about the same, you will pay about the same amount of AMT in 2009. AMT mainly impacts taxpayers with income between \$150,000 and \$400,000, especially people with high property and state income taxes (not deductible for AMT), and numerous dependents (no personal exemptions for AMT). What can you do to minimize AMT? Avoid doubling up on real estate tax payments (if you pay your real estate taxes in December, continue this pattern; same if you normally pay your taxes in January). Similarly, if you pay your 4<sup>th</sup> quarter state estimated taxes before December 31<sup>st</sup>, do so again (but if you pay in January each year, continue this pattern).
- 3) **Charitable Donations:** Charitable contributions mailed or charged by December 31<sup>st</sup> are deductible in 2009. Laws passed in 2006 require a bank record or written communication from the charity showing the donation amount and date for all donations under \$250, and both a bank record and written communication for donations to any charity of \$250 or more on a single day. For donations done through payroll (like United Way), keep something from the employer showing the payroll deduction (i.e. year-end pay stub) and a pledge card or document prepared by the charity. As always, the value of any goods or services received must be subtracted from the donation (i.e. girl scout cookies, item purchased at auction, etc.). Non-cash donations over \$5,000 (except publicly traded stock) require a written appraisal. Car or boat donations over \$500 are limited to the amount reported by the charity on Form 1098-C (which must be sent to the IRS with the tax return).
- 4) **Child and Dependent Care Expenses:** A dependent care plan at work allows up to \$5,000 of expenses to be paid pre-tax. Qualifying expenses include daycare costs, in-home care, nursery or pre-school costs, before or after-school care, and camps (including those specializing in a particular activity like sports camps, but not overnight camps). The cost of summer school or tutoring does not qualify. Qualifying dependents include children under age 13 (for care up to their 13<sup>th</sup> birthday, although the actual payment can be after that date), as well as a disabled dependent or spouse. If you have expenses in addition to those reimbursed through a pre-tax plan, there is a tax credit that you can claim on your federal return based on up to \$3,000 of expenses (\$6,000 for taxpayers with two or more dependents) although you first have to subtract the amount paid through a pre-tax plan.
- 5) **Pre-Tax Medical Savings Plans:** If you participate in a medical savings plan at work where you “use it or lose it,” remember that many over-the-counter items can be reimbursed under these plans. If you have money left over at year-end, don’t forfeit it. Ask your company for a list of items you can buy. You effectively save to a 40% (depending on your tax bracket) for purchases through the plan.
- 6) **Health Savings Accounts (HSA):** If you have a high deductible health insurance plan (i.e. an annual deductible of at least \$1,150 (\$2,300 family)), you can contribute to an HSA. Contributions are limited to \$3,000 for individuals and \$5,950 for families (\$3,050 and \$6,150 for 2010). Individuals age 55 or older can contribute an extra \$1,000. The deadline is April 15<sup>th</sup> of the following year. Contributions cannot be made after age 65, but withdrawals after age 65 continue tax-free. Wisconsin still does not recognize HSAs (contributions are added back to determine state income).
- 7) **Investment Strategies:**
- In your taxable accounts (not IRA or retirement plans), consider selling losing investments before year-end so that you can deduct the loss in 2009. Gains and losses are first netted, but if the net result is a loss, you are allowed to deduct up to \$3,000 (\$500 for Wisconsin) against ordinary income. Any excess loss is carried over to future years. A popular year-end strategy (referred to as “loss harvesting” is to sell stocks or mutual funds where you have losses and buy similar (not the same) stocks or funds to maintain your position. If you buy back the same exact investment within 30 days of sale (including reinvestment of distributions), your loss will be limited under the “wash sale” rules.
  - In your taxable accounts, be careful of large investments in mutual funds late in the year. You may wind up paying tax on a large distribution (in effect, part of your principal is returned to you and taxed as income). Before a large December investment, check if a distribution is still planned. If the income would be significant, consider waiting to invest until after the dividend record date.
  - If you are in the 25% or higher tax bracket, consider federally tax-exempt investments (for example, a tax-exempt money market or municipal bond fund) to increase your after-tax return.

- d) If your taxable income (income after subtracting deductions) is expected to be unusually low this year, bringing you below the end of the 25% federal tax bracket (about \$34,000 single and \$68,000 married), most likely it would make sense to increase your taxable income:
- Consider a Roth conversion (i.e. converting some or all of your Traditional IRA into a Roth IRA). This is allowed if your AGI (adjusted gross income) is below \$100,000. Conversions are especially attractive if your investment has lost value and you expect it to recover, since the amount taxed as income is the value at the time you convert (and subsequent income/gains in your Roth IRA are tax-free).
  - Because of the 0% tax rate on long-term capital gains realized in 2008 – 2010, consider selling investments with realized gains. Keep in mind that the 0% rate applies only until you reach the end of the 25% federal tax bracket. Also, children whose income is subject to the “Kiddie Tax” (see “Income Earned by Children” under “Tax Highlights”) do not receive the 0% rate because they are being taxed at their parent’s tax rate.

## 8) Education Savings:

- a) Section 529 plans (such as EdVest in Wisconsin) are one alternative for education savings. Earnings are not taxed if the money is used to pay for education costs. There is no federal tax deduction for contributions, but parents, grandparents, aunts, uncles and great-grandparents receive a Wisconsin tax deduction on up to \$3,000 of EdVest contributions per child per year (or for yourself or your spouse), saving about \$200 in state taxes for each \$3,000 contribution.
- b) Another alternative is a Coverdell Education Savings Account (CESA). The annual contribution limit remains \$2,000, but is further limited if your joint income is over \$190,000 (\$95,000 for single taxpayers). However, other family members (including your child) can contribute to the CESA if the parent’s income is too high. CESA contributions can be made as late as April 15<sup>th</sup> of the next year. There is no tax deduction, but earnings are tax-free if the money is used to pay education costs.
- c) Before depositing money into education accounts, be sure to first take full advantage of IRAs and retirement plans since this is better for taxes and financial aid. If you save enough for retirement, you will be in excellent financial shape and can help your child with college costs. You can use student loans to pay college costs, but there are no loans for retirement. Contribute to Roth IRAs if you are eligible. You can withdraw Roth contributions at any time, without tax or penalties, so Roth IRAs give you the flexibility to use savings for retirement and/or college costs.

## 9) Tuition: Review tuition paid this year and expected for next year (including tuition paid using loans). Consider whether to pay for the spring semester in December or January (the payment date is critical because a payment in December 2009 counts for 2009 deductions and credits, not 2010 when the student actually attends class). Shifting payments between years may allow you to take advantage of one of the available tax breaks for an extra year.

- a) Federal American Opportunities Credit - for 2009 and 2010 only:
- Up to \$2,500 tax credit per student (100% of first \$2,000 of tuition & books/supplies/equipment + 25% of next \$2,000)
  - Enrolled at least half-time; available for 4 years of undergraduate tuition (Freshman – Senior)
  - Credit phases-out for couples with income between \$160k-\$180k (for single filers \$80k- \$90k)
  - Up to \$1,000 is refundable (but none is refundable on a dependent child’s tax return)
- b) Federal Hope Credit (school is within Midwest Disaster Area) – for 2009 only:
- Up to \$3,600 tax credit per student (100% of first \$2,400 of qualified expenses paid + 50% of next \$2,400; qualified expenses include tuition, books/supplies/equipment, and room & board)
  - Enrolled at least half-time; for 2 years of undergraduate tuition (Freshman – Sophomore)
  - Credit phases-out for couples with income between \$100k- \$120k (for single filers \$50k- \$60k)
  - Cannot claim the American Opportunities Credit for any other students
- c) Federal Lifetime Learning Credit:
- Up to \$2,000 tax credit per student (20% of first \$10,000 of tuition paid)
  - School within Midwest Disaster Area - for 2009 up to \$4,000 tax credit per student (40% of first \$10,000 tuition, books/supplies/equipment and for at least half-time students, room & board)
  - Available for both degree and non-degree programs; no limit on number of years claimed
  - Credit phases-out for couples with income between \$100k-\$120k (for single filers \$50k- \$60k)

- d) Federal Tuition Deduction (amount is a total, not per student):
- \$4,000 tuition/books deduction if income is \$130k or less (\$65k or less for single filers)
  - \$2,000 tuition/books deduction if income is \$130,001-\$160,000 (\$65,001-80,000 for single)
  - Available for all undergraduate and graduate levels; no limit on number of years claimed
  - Cannot also claim an American Opportunities, Hope or Lifetime Learning Credit for the student
- e) Wisconsin Tuition Deduction (per student):
- \$6,000 deduction for in-state tuition if income is \$80k or less (\$50k or less for single filers); deduction is reduced if income is \$80k-\$100k (\$50k-\$60k for single filers)

**10) Retirement Contributions:**

- a) Contribution limits for IRAs and various plans are as follows:

2009 & 2010	IRAs		401(k), 403(b), 457(b) Plans		SIMPLE Plans	
	< Age 50	Age 50+	< Age 50	Age 50+	< Age 50	Age 50+
	5,000	6,000	16,500	22,000	11,500	14,000

- b) The income limits for allowing IRA contributions are as follows:

	<u>Joint Taxpayers</u>	<u>Single/HOH Taxpayers</u>
Roth IRA for 2009	\$166k - \$176k phase-out	\$105k - \$120k phase-out
Roth IRA for 2010	\$167k - \$177k phase-out	\$105k - \$120k phase-out
Traditional IRA - deductible:		
No employer plan	Always allowed	Always allowed
Covered by employer plan:		
For 2009	\$89k - \$109k phase-out	\$55k - \$65k phase-out
For 2010	\$89k - \$109k phase-out	\$56k - \$66k phase-out
Spouse has employer plan:		
For 2009	\$166k - \$176k phase-out	NA
For 2010	\$167k - \$177k phase-out	NA
Traditional IRA – nondeductible	Always allowed	Always allowed

- c) Remember that IRA contributions are only allowed to the extent of earned income (wages, self-employment income, etc.). It's fine if only one spouse earns the income - both individuals can contribute to an IRA to the extent of joint income. Children can contribute to IRAs if they have earnings (there is no minimum age). If you are age 70½ or older at year-end, you can contribute to a Roth IRA but not a Traditional IRA. You have until April 15<sup>th</sup> of the next year to contribute.
- d) If you are self-employed, consider a SEP IRA, SIMPLE IRA or single-person 401(k). SEPs can be set up even after December 31<sup>st</sup> (not SIMPLE and 401(k) plans). Funding can be as late as April 15<sup>th</sup> (or later with an extension). Except for corporations, contributions are based on net business income, therefore your exact contribution limit is determined when I prepare your return.
- e) If your employer allows you to contribute to a Roth 401(k) account (versus pre-tax contributions), I recommend taking advantage of Roth accounts under two scenarios: 1) If you think you are likely to be in a higher tax bracket in the future or 2) if you already have significant pre-tax retirement savings and want to diversify from a tax perspective.
- f) Taxpayers with income > \$100,000 are prohibited from converting Traditional IRAs into Roth IRAs. **Starting 1/1/10, the \$100,000 income limit is eliminated (see p.1 for further discussion).**
- g) For defined contribution plans, the maximum contribution (employee + employer) is the lesser of 25% of compensation or \$49,000. Individuals age 50 or older are allowed \$5,500 more. "Compensation" is capped at \$245,000. These amounts remain the same for 2010.
- h) There is a "saver's credit" on the first \$2,000 of contributions to IRAs and employer plans. The credit reduces federal tax at the rate shown below, depending on 2009 income:

<u>Married</u>	<u>Head of Household</u>	<u>Single</u>	<u>Credit Rate</u>
Up to \$33,000	Up to \$24,750	Up to \$16,000	50%
\$33,001 - \$36,000	\$24,751 - \$27,000	\$16,001 - \$18,000	20%
\$36,001 - \$55,500	\$27,001 - \$41,625	\$18,001 - \$27,750	10%

**11) Required Withdrawals from IRAs/Retirement Plans:** Required Minimum Distributions (RMDs) have been suspended for 2009 only. For individuals who reach age 70½ during 2010, it is very important to start withdrawing money from Traditional IRAs and retirement plans. The government imposes a nasty penalty (**50%! of the under-withdrawal**). You must withdraw your RMD by December 31<sup>st</sup> each year, except in the year in which you first turn 70½, when the deadline is extended to April 1<sup>st</sup> of the following year (but then you will receive two year's worth of distributions in one tax year). There is an exception from the RMD requirement if you have not yet retired from a job (but the exception doesn't apply if you own the company). Also, withdrawals are not required from Roth IRAs at a specific age.

**12) Business Purchases:** If you are planning to purchase business equipment soon, consider doing so by December 31<sup>st</sup> to get a write-off ("Section 179" expense) against your 2009 income. Note that Section 179 doesn't apply to landlords, as renting is not considered a business under tax law. You can expense up to \$250,000 of capital items on your federal return for 2009 (versus depreciating the cost over the asset life). This limit drops to \$134,000 for 2010. For Wisconsin taxes, only \$25,000 of capital items can be expensed under Section 179 each year, and off-the-shelf software is excluded.

**13) Business/Rental/Farm Expenses:** Don't forget small out-of-pocket costs. If you own a corporation, partnership or LLC, reimburse yourself for business expenses paid personally. If you are a sole proprietor, comb through your records now to maximize your deductions. Remember that amounts charged to a credit card are considered paid (it's an expense in the year the item is charged to your credit card, not when you make a payment on the credit card). The key to being able to deduct an expense is that it's "ordinary and necessary" to your business or rental activity. Here is a reminder of expenses that may be overlooked:

- Office and computer supplies, miscellaneous software and postage
- Entertainment costs (for clients and employee gatherings)
- Gifts for business reasons (up to \$25 to an individual)
- Business subscriptions, dues to professional groups and continuing education
- Promotional and advertising costs
- Travel expenses (keep a mileage log to deduct business use of your vehicle)
- Internet and cell phone costs, and long-distance charges to your home phone
- Interest on credit cards (prorated between personal and business if used for both)
- Legal and accounting fees

**14) Business Form 1099s:** Your business may need to file 1099-MISC Forms (due January 31<sup>st</sup>). If your business paid more than \$600 to a vendor for services (not products), you are required to send a 1099-MISC to the vendor, the IRS and the state. This does not apply if the vendor is a corporation (except 1099-MISC forms are required to be sent to attorneys and medical care providers even if they are incorporated). Call me if you have any questions or would like me to prepare your 1099s.

**15) Estate Planning & Gifts:** For one year only (2010), the estate tax is repealed, but starting 2011 the estate tax exemption returns to \$1 million (the level it was in 2002), and the top estate tax rate is 55% (same as it was in 2001). If you have significant wealth and you have not met with an attorney in the past few years to review your wills, trusts, and other estate planning documents, I recommend you do so. If you do not have a will or health care power of attorney, have the documents prepared. If you give more than \$13,000 to any individual in 2009 (same for 2010), you are required to report the gift to the IRS on Form 709. Gift tax (paid by the giver) is not due until lifetime gifts reported on Form 709 exceed \$1 million. Certain gifts are not reported on Form 709, such as gifts to spouses or directly paying someone's medical or education expenses.

I hope this summary is helpful to you. This is only a summary and additional "details" may have a material impact. Please feel free to call or e-mail if you would like to discuss any of these items or other issues, especially before you decide to proceed with a large transaction. Thank you for your business and I look forward to working with you next year!

Judy