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NAME  
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Re: 2010 Tax Planning Letter Update No. 4

Dear NAME,

One word sums up the current tax environment – uncertainty. This election is now over so it will be interesting to see if those in Washington can agree on how to deal with the coming sunset of the 2001 tax law.

The main issue is whether to extend the 2001 tax rates, or to extend them for some but not all, or to extend them permanently or only temporarily. But there are other provisions in the 2001 law that, if not extended, could increase the taxes you pay. Among the issues: the marriage penalty, itemized deductions and personal exemptions for higher-income taxpayers, the child tax credit, the dependent care credit, the alternative minimum tax, capital gains and dividend taxes, and the estate tax.

Planning is difficult when the rules are in a constant state of flux, but there are actions you can take to manage your tax bill. You, our clients, are the most important people in our office. We are committed to working with you to find the tax strategies best suited to your individual situation. If you have questions about anything in this *Letter* or about the tax-cutting options you should consider, please contact us. And if you have friends or associates who might be interested in tax planning information, feel free to share this *Letter* with them.

## **Tax planning will head you in the right direction**

Creating a sensible tax plan for yourself and your business is not an easy task in today's political environment. If you're looking for straightforward, reliable ways to save tax dollars, here are some year-end suggestions to consider.

### **■ Compare tax rates**

Tax rates are as low this year as they're likely to be for many years to come. You could save taxes by realizing income in 2010 instead of following the more traditional practice of deferring gains or other income into the future. Why? Accelerating income is a multi-year tax-saving strategy when you anticipate higher tax rates in the future.

If you're a business owner, finish projects in December and submit the related invoices to your customers before the end of the year. If you're an investor, 2010 might be the year to elect out of installment sale treatment on asset dispositions.

## ■ Check home and family

Use a whole-family approach to tax planning. For instance, you could hire your child to work in your business. That shifts income from your higher tax bracket to your child's lower one. There's no need to worry about the "kiddie tax" if you opt for this strategy. While the investment income of children under age 19 (and full-time students under age 24) can be taxed at your rates, earned income is not included in the kiddie tax calculation.

If you bought a home this year, you're well aware of the tax credit available to you. But don't forget that if you bought a home in 2008 and took the first-time homebuyer credit, the recapture of that credit starts this year. The \$7,500 credit must be repaid over 15 years beginning with your 2010 tax return.

Take advantage of expiring residential energy credits. For 2010, you can claim a credit of up to 30% of the cost of energy-efficient windows, doors, certain roofs, and other energy-saving improvements to your principal residence. The maximum residential energy credit for amounts spent in 2009 and 2010 is \$1,500.

**TIP:** Credits are more valuable than deductions because they're subtracted directly from the amount of tax you owe.

## ■ Convert to a Roth

If transferring assets from your IRA to a Roth makes sense based on your overall tax situation, you have a unique opportunity this year. You can opt to accelerate income by including the entire 2010 conversion amount on this year's federal tax return, or you can delay income recognition until 2011 and 2012.

**TIP:** The \$100,000 income-eligibility limit that used to restrict who could make Roth conversions no longer applies. You can transfer your traditional IRA assets to a Roth account no matter how much you earn. In addition, you can now make a conversion when you are married but file separate returns.

## ■ Make gifts

Take advantage of the 2010 gift tax exclusion by making gifts before December 31. The first \$13,000 that you gift to any one donee during 2010 is not taxable. You can gift up to \$26,000 tax-free if you elect to split the gift with your spouse.

Gifts of income-producing assets such as dividend-paying stocks can reduce your future taxable income because you're transferring future income to the donee.

## ■ Bunch deductible expenses

When you're married and file a joint return, the standard deduction for 2010 is \$11,400 (\$5,700 for singles). If your itemized deductions are close to this amount, you may benefit from "bunching," or accumulating expenses into one year. You can then alternate between itemizing one year and taking the standard deduction the next, saving tax dollars by doing so. Items to review when deciding on the bunching strategy: medical and dental expenses, real estate and personal property taxes, mortgage interest payments, charitable contributions, dues, and subscriptions to professional journals.

**TIP:** When making the choice between itemizing and using the standard deduction for 2010, be aware that higher-income taxpayers get the full deduction for their itemized deductions this year. Next year the income-based reduction on total itemized deductions is scheduled for reinstatement. Also, keep the alternative minimum tax (AMT) calculation in mind. The standard deduction offers no benefit when you're subject to the AMT, and neither do certain itemized expenses.

### ■ Analyze equipment purchases

Can you get a good deal on business equipment you need before January 1? Electing to expense the cost of assets you purchase and use in your business before the end of the year is a standard tax-saving move. If you're unable to use the entire deduction, you can carry the excess to future years. However, you must make the election on this year's return. For 2010, the maximum Section 179 deduction is \$500,000. And don't overlook the reinstated 50% bonus depreciation for new equipment purchases.

### ■ Gather records for business credits

The small business health care credit reduces your business tax bill by up to 35% of eligible premiums you pay for your employees' health insurance. The full credit is available when you have ten or fewer workers who earn average annual wages of \$25,000 or less.

A law enacted in March offers two new benefits for hiring unemployed workers. First, for 2010 you can claim a payroll tax exemption from your share of the social security tax on wages you pay to qualifying new hires through December 31. Second, for 2011 you'll be eligible for the new hire retention credit for wages you pay to those qualifying employees who stay on the job for 52 weeks. The maximum credit is \$1,000.

There are always reasons to put off year-end income tax planning, and 2010 is no exception. Yet waiting to the last minute can make it difficult to implement asset and income management techniques that will minimize your taxes. These ideas will give you a starting point for early action. We urge you to call and schedule a tax review. We're ready to provide practical tax-saving suggestions, as well as updates on legislation that could affect you.

## New tax breaks for business

The *Small Business Jobs Act of 2010*, signed into law on September 27, creates several tax-saving opportunities for businesses. Here's a summary of the key tax breaks.

- **Section 179 deduction.** The new law doubles the maximum amount that can be deducted for business equipment purchases to \$500,000 for 2010 and 2011. Also, the dollar threshold at which the maximum deduction is phased out is increased from \$800,000 to \$2 million.
- **Bonus depreciation.** The new law revives 50% bonus depreciation for qualified property placed in service in 2010 (through 2011 for certain property).
- **Start-up expenses.** For 2010, the maximum deduction for qualified costs of starting a business is increased to \$10,000, with a \$60,000 phase-out threshold.

- **Qualified small business stock.** Investors in “qualified small business stock” may be able to exclude 100% of the gain from the stock’s sale if it is held at least five years (for acquisitions from September 27, 2010, through December 31, 2010).
- **Business credits.** Normally, general business credits can’t offset alternative minimum tax (AMT) liability. The new law removes this restriction for an “eligible small business” and permits carrybacks of general business credits for five years.
- **Health insurance.** For 2010 only, self-employed individuals can deduct health insurance costs from their self-employment income in computing self-employment tax.
- **Cell phones.** The new law removes strict substantiation requirements for cell phones and similar devices used in business and treats employee use as a tax-free fringe benefit.
- **Roth accounts.** Effective September 27, 2010, participants in 401(k), 403(b), and 457(b) plans can roll over funds to a Roth account. For rollovers in 2010, the resulting taxable income can be divided between 2011 and 2012.

## **Eight year-end tax cutting moves to consider**

1. Stock up on over-the-counter medications that you pay for through a flexible spending account or similar health account. Next year, you’ll need a prescription to buy these items from any tax-advantaged health account.
2. Check your 2010 tax payments, and if you haven’t met the minimum requirement, increase your withholding before year-end to eliminate or reduce underpayment penalties.
3. Required minimum distributions are back for 2010 and must be taken by December 31, or you face a 50% penalty. If you just turned 70½ this year, you could wait until next April 1 to take your first distribution. In deciding, consider the likelihood of higher tax rates next year and the fact that a delay means you’ll have two taxable distributions for 2011.
4. If you sell some, but not all of a particular stock or mutual fund, specify that you’re selling those shares with the highest cost in order to minimize your taxable gain or maximize your loss.
5. Give appreciated stock to charity. You can generally deduct the fair market value and pay no capital gains tax on the appreciation. If you have stock that has declined in value, sell it to take the tax loss; then give the cash to charity.
6. Start a retirement plan for your small business. You may be entitled to a credit of up to \$500 in each of the plan’s first three years.
7. Get back on track with your retirement savings. Contribute the maximum to your 401(k), SIMPLE, or IRA.
8. Get the documentation you’ll need for all your 2010 charitable contributions, or you risk losing your deduction. Even gifts under \$250 require a bank record or a receipt from the charity.

## **Harvesting losses can be a smart tax strategy**

As the end of the year approaches, you should carefully examine your investment portfolio. Depending on your situation, it may be beneficial tax-wise to sell securities that have declined in value and offset the loss against gains recognized earlier in the year. But there are a few other factors to consider, including transaction costs and your overall investment strategy.

### **How it works**

To compute your taxable capital gain or loss for the year, you must first net your short-term gains and losses and your long-term gains and losses. A gain or loss is long-term if you've held the asset more than one year. For 2010, net long-term gain is taxed at a maximum tax rate of 15% (0% for individuals in the regular 10% and 15% tax brackets). In contrast, short-term gains are taxed at ordinary income rates.

If you're currently showing an overall gain for 2010 stocks you've sold, selling stocks up to that amount will offset the gain. For instance, assuming you've realized \$10,000 in gains, you can sell stock at a \$10,000 loss to completely eliminate the tax on the gain. If the loss exceeds the amount of the gain, you can use the excess to offset up to \$3,000 of ordinary income. Any remaining loss is carried over to future years.

Conversely, if you're currently showing an overall loss, you might do the opposite: Sell stocks at year-end that have gained in value. The gain is effectively tax-free up to the amount of your losses.

### **The "wash sale" rule**

If you're planning to harvest tax losses this year, watch out for the "wash sale" rule. The rule prohibits you from claiming a tax loss on the sale of securities if you reacquire the same or "substantially identical" securities within 30 days of the sale. The easiest way to avoid this trap is to wait at least 31 days to buy back the same or similar securities.

### **Changing tax rates**

Other tax complications may arise due to changing tax rates. It's generally expected that tax rates will be higher in the future. Currently, the maximum tax rate on long-term gain is scheduled to increase to 20% in 2011 (10% for lower-income taxpayers), while the top two ordinary income rates are also scheduled to rise. Thus, a loss could become more valuable to you next year and beyond. Practical advice: Base your tax-related decisions on what you know for certain.

Finally, don't discount other economic factors besides taxes. Do what makes the best overall financial sense for your portfolio. For guidance in analyzing the tax aspects of your investment decisions, give us a call.

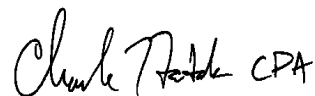
## **Gear up for new recordkeeping rules**

The IRS is always concerned about the “tax gap,” the difference between the taxes that should have been paid and the amount that is actually paid. It’s estimated that the tax gap runs in excess of \$300 billion a year. Underreporting income accounts for a large part of the tax gap, and the largest subcomponents of underreporting include understating income, taking improper deductions, and overstating business expenses. Noncompliance is highest where there is no third-party reporting, such as there is with W-2s and 1099 information slips.

Congress has added a slate of new filing requirements designed to reduce the tax gap by exposing underreported income. Both individuals and businesses may have to change their recordkeeping methods in order to comply with the new rules. Here are some details.

- Beginning with 2011 forms, employers must disclose on each employee’s W-2 the value of health insurance provided by the company. The amount is shown for informational purposes only; it is not taxable income to the employee.
- Investment brokers are required to report the cost basis of securities acquired and sold after 2010. Congress hopes this will minimize errors made by individual taxpayers in calculating capital gains taxes due on stock sales.
- Credit card and other third party payers must report to the IRS payments made to participating merchants. As a result, the IRS will know each year how much every business collected from credit card sales. This requirement goes into effect for 2011 payments.
- A rule that doesn’t take effect until 2012 will change the requirement for filing Form 1099 for payments made to vendors for goods or services totaling \$600 or more per year. The revised rule will include payments made to corporations. Business groups are seeking repeal of this rule, citing its cost and added paperwork burden for small companies.
- Beginning in 2011, individuals who receive income from rental property (with some exceptions) are required to file information returns with the IRS for annual payments of \$600 or more for rental property expenses. A copy of the Form 1099 must be sent to the provider of the services.

Cordially,



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*NOTE: This newsletter is issued annually to provide you with information about minimizing your taxes. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*