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End-of-the-Year Tax Planning

Some of the typical end-of-year tax planning moves may need to be reconsidered given changes to applicable tax provisions in 2009 and 2010. It may be wise to delay charitable contributions and property tax payments until 2010 or to advance a planned purchase of qualified property into 2009 instead of 2010. Here's a look at some possible strategies.

As 2009 draws to a close, many people try to make some last-minute financial moves for tax planning purposes. This year, they may need to rethink some of the traditional tax strategy moves for December as a result of applicable tax provisions in 2009 and 2010. This article will review some of the provisions and discuss some unconventional thinking for the end-of-year tax planning that may apply to your clients, your family, or even you.

Required Minimum Distributions

Section 201(a) of the Worker, Retiree, and Employer Recovery Act of 2008 provides a one-year suspension of the required minimum distribution (RMD) rules for calendar year 2009 from defined contribution plans (IRC §401(a), §403(a) and §403(b)), certain IRC §457(b) plans, and individual retirement plans. Thus individuals have the option to take or not take a distribution from their plan for 2009. For the moment, this is only a one-year suspension. The application of this suspension is straightforward, but there are a few issues to be mindful of. First, a person turning 70.5 in 2008 is required to take the first RMD by April 1, 2009, for 2008 but isn't required to take the second RMD by December 31, 2009, for 2009. Likewise, a person turning 70.5 in 2009 isn't required to take the first RMD by April 1, 2010, for 2009 but is required to take the second RMD by December 31, 2010, for 2010.

Cut-Back Rule

For taxpayers whose adjusted gross income (AGI) exceeds $166,800 ($83,400 for married filing separate tax returns) for tax year 2009, IRC §68 provides that the amount of itemized deductions otherwise allowable for the tax year are reduced by the lesser of 1% of the AGI amount exceeding the threshold limits or 80% of the amount of the itemized deductions for the taxable year. For example, a taxpayer with an AGI of $220,000 will effectively lose $832 (1% of ($250,000 – $166,800)) of otherwise deductible itemized deductions in 2009, a tax increase of approximately $200.

But the cut-back rule is phased out for 2010. Thus, a taxpayer will be able to deduct his or her full amount of itemized deductions in 2010. In the above example, the taxpayer would increase his or her itemized deductions by $832, a tax savings of approximately $200. But then in 2011, the original cut-back rule returns, and taxpayers lose 3% of their itemized deductions above the threshold limit. The lost itemized deductions in the earlier example increases to $2,496 (3% of ($250,000 – $166,800)), a tax increase of approximately $600. Because the threshold amount of $166,800 is adjusted annually for inflation, the actual tax increase would be less because the threshold amount would have increased for both 2010 and 2011.

Although it may be impossible to shift some income from 2009 to 2010, thereby reducing the effects of the cut-back rule, an individual still has time to shift some tax deductions from 2009 to 2010 and increase total allowable deductions over the two-year period. For example, an individual may want to delay some charitable contributions until January. Likewise, it may be better not to make the January 2010 mortgage payment in Decem-

ber 2009 and, if possible, make the December 2009 mortgage payment in January 2010. If a taxpayer generally makes a property tax payment in December, it might be wise to postpone that payment until January. Obviously, the objective here is to shift some of the allowable itemized deduction from 2009 to 2010 in order to thereby maximize the overall deductions over the two-year period.

On the flip side, an individual needs to start considering the tax changes that are due in 2011. As a result, an individual may want to incorporate the opposite strategy; that is, advance to the end of 2010 some payments that otherwise would be made at the start of 2011. For example, a person may want to prepay state income taxes for 2011 in 2010. There's a two-sided effect to this tax strategy. First, it increases the itemized tax payments for 2010. Second, it simultaneously increases the income in 2011 from the larger state income tax refund, which also reduces itemized deductions in 2011.

Small Businesses

Taxpayers may want to incur some expenses in 2009 that are above the line deductions to reduce their AGI figure. The purchase and placing in service depreciable property by businesses is an ongoing process that requires business owners to evaluate the value of retaining or replacing the property. The overriding factor in this decision process is the added value offered by technological improvements to the productivity of equipment as well as the age and maintenance cost of the existing equipment. For 2009, IRC §179 and bonus depreciation tax provisions become additional factors to be considered by owners when contemplating the replacement of, or additions to, existing equipment.

IRC §179 (also known as immediate expensing) permits small business owners to annually expense for taxable year 2009 up to $250,000 of the cost of qualifying property placed in service for the taxable year. (The amount decreases to $125,000 for 2010 and $25,000 for 2011.) In general, qualifying property is defined as depreciable tangible personal property (i.e., §1245 property) that's purchased for use in the active conduct of a trade or business. The $250,000 amount is decreased dollar for dollar when a business places more than $800,000 of qualified property in service during the tax year. That is, a business that places $860,000 of qualified property in service in 2009 would be eligible to deduct $190,000 under IRC §179. The remaining $670,000 would be eligible for bonus and MACRS depreciation.

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In addition to IRC §179, a business owner is able to claim an additional first-year depreciation deduction (also known as bonus depreciation) in the amount of 50% of qualified property placed in service in 2008 or 2009 only. Depreciable property that generally qualifies for the 50% bonus depreciation in 2009 includes MACRS property (with a useful life of 20 years or less), computer software (not amortized under IRC §197), water utility property, and qualified leasehold improvement property. This provision is automatic unless the taxpayer elects out of the provision.

Finally, the business taxpayer can depreciate the remaining adjusted basis of the first-year property under the MACRS tax provision over the asset's life. For instance, in the earlier example, the business owner placed in service $860,000 of qualified property for which he was able to claim $190,000 under IRC §179. The adjusted basis of the property after §179 is $670,000, and this amount would next qualify for bonus depreciation of $335,000 ($670,000 × 50%). The remaining adjusted basis of $335,000 ($860,000 – $190,000 – $335,000) would further be reduced by the depreciation as calculated under MACRS. If these assets were listed as five-year property, then an additional $67,000 ($335,000 × 20%) would be depreciated (assuming that most of the purchases occurred prior to the fourth quarter). In total, this taxpayer would be able to depreciate a total of $592,000 of the $860,000 property placed in service.

Several Options

Tax planning always is an art, and 2009 is no exception. As shown in this article, a taxpayer may be wise to delay a payment until 2010 (e.g., charitable contributions and

continued on page 61

Taxes

continued from page 14

property tax payments) or make a payment in 2010 for 2011 and likewise advance a purchase (e.g., qualified property) in 2009. Of course, these are just a few of the possible opportunities. **SF**

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