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Client Information Bulletin

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Year-end Tax Moves for Individuals

Assess your situation in complex times

Year-end tax planning is especially complicated this year. **Reason**: As a general rule of thumb, individuals may try to accelerate deductions into the current year and defer income to the next year. But income tax rates are scheduled to increase in 2011. Furthermore, special tax reductions for long-term capital gains and dividends are scheduled to expire after 2010. Adding to the complexity, proposed legislation could modify the rules or extend tax breaks beyond this year.

Nevertheless, you can take certain logical steps at year-end. Here are several areas to consider:

Capital gains and losses: Absent other circumstances, you may want to realize capital gains to offset capital losses from earlier in the year. Net long-term capital gain for the year is currently taxed at a maximum rate of 15% (0% for taxpayers in the regular 10% or 15% brackets). Therefore, it may make sense for individuals in lower tax brackets—such as your children—to sell securities or other property at year-end. **Caveat**: Watch out for possible "kiddie tax" complications (see "family-income splitting" at right).

Alternative minimum tax: Despite another bump in the exemption amounts for 2010, you still may be required to pay the alternative minimum tax (AMT). Have your professional tax preparer estimate your AMT liability for this year. It might be advisable to shift certain "tax preference items" to 2011 to avoid or reduce AMT liability. Alternatively, you might accelerate income into 2010 if the AMT rate is lower than your expected top marginal tax rate.

Charitable donations: Generally, you can deduct the full amount of cash donations made before year-end. If a donation is made by credit card or posted online, you can deduct it on your 2010 return, even if the charge is not actually paid until next year. But you might postpone gifts if you will be in a higher tax bracket in 2011. **Reminder**: The tax law imposes strict substantiation requirements.

Family-income splitting: You may be able to reduce the overall family tax bill by shifting income-producing assets to family members, such as your children, in lower tax brackets. However, the kiddie tax may dilute this strategy. Generally, unearned income over $1,900 received by a child younger than 19 or a full-time student younger than 24 in 2010 is taxed at your top marginal tax rate. Try to keep a child's unearned income near or below the $1,900 level.

Medical and dental expenses: You may deduct unreimbursed medical and dental expenses to the extent the annual total exceeds 7.5% of your adjusted gross income (AGI). When

Inside

Year-end Tax Moves for Business Owners

Key Provisions of New Financial Law

Noncompete Agreements: Tax Angles

Guard Against Five 401(k) Mistakes

Facts and Figures

it is possible, try to bunch nonemergency expenses (e.g., new eyeglasses or dental cleanings) in the tax year that provides the best opportunity for a deduction. **Note**: Under the new health care legislation, the threshold for medical expenses is scheduled to increase to 10% of AGI, beginning in 2013.

Estimated tax: An individual may have to pay an "estimated tax penalty" if the amount of requisite income tax is not paid through a combination of withholding or quarterly installments. But no penalty is imposed if payments equal 90% of your 2010 liability or 100% of your 2009 liability (110% if AGI was above $150,000). When possible, adjust withholding to qualify under one of these "safe harbor" exceptions.

Energy credits: You may claim a residential energy credit for 30% of the cost of qualified energy-saving installations. The maximum credit is $1,500 for expenses incurred in 2009 and 2010. For instance, if you claimed a $500 credit in 2009, the maximum credit you are allowed for 2010 is $1,000.

Remember*: This is only a general overview of several tax-planning techniques for individuals. Consult a professional adviser before taking any action.*

Year-end Tax Moves for Business Owners

Coordinate a plan for your small business

Small-business owners may also benefit from certain tax strategies implemented at the end of the year. Of course, any new legislation may have a substantial impact. Accordingly, here are several ideas to consider:

Section 179 deduction: Under Section 179 of the tax code, a business may "expense," or currently deduct, the cost of qualified assets placed in service during the year. Due to recent tax legislation, the maximum Section 179 deduction allowed for 2010 is $250,000. **Note**: The Section 179 deduction is reduced on a dollar-for-dollar basis if the cost of assets placed in service exceeds $800,000.

HIRE Act tax breaks: The Hiring Incentives to Restore Employment (HIRE) Act of 2010 creates two key tax breaks for employers. (1) The employer's share of the 6.2% Social Security tax on wages is waived if you hire a "previously unemployed" worker. (2) An employer may qualify for a special tax credit for retaining the worker. Both tax breaks are no longer available after 2010.

Travel: Travel expenses incurred by your employees—such as airfare, lodging and 50% of the cost of meals—may be deducted for business-related trips. When appropriate, move up business trips planned for January into December. This allows you to write off travel expenses on your 2010 return instead of waiting until 2011. **Caveat**: Unreimbursed travel expenses must be deducted as miscellaneous expenses subject to the usual 2%-of-AGI limit.

Bad business debts: In these uncertain economic times, a business may have difficulty collecting some debts. As a general rule, the bad debts of a business may be deducted from gross income when they become worthless. Business owners should keep records of all collection efforts, such as letters, telephone calls, e-mail communications and collection agency activities, to support deductions based on the worthlessness of the debts.

Repairs and improvements: Generally, if you simply repair a business asset, you may currently deduct the entire cost. In contrast, the cost of an improvement to business property must be capitalized. Try to take care of minor repairs before the end of the year to offset your taxable income for 2010. **Caution**: If you make repairs and improvements at the same time, the IRS may lump in the cost of the repairs with the improvements as a general betterment plan.

Section 199 deduction: A deduction under Section 199 may be claimed by a business entity with "manufacturing" activities. For 2010, the deduction equals the lesser of 9% (up from 6% in 2009) of either taxable income from qualified production activities or taxable income.

Tax planning cannot take place in a vacuum. Have the year-end tax strategies for your small business coordinated by a professional adviser.

Give Us A Call!

Do you have any questions or comments about this newsletter or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.

Key Provisions of New Financial Law

Numerous reforms may affect consumers

The massive new financial reform law—officially titled the "Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010"—spans more than 2,300 pages. It includes significant changes for individuals, businesses and the financial community. Here are some of the key provisions that may affect consumers in the coming years.

Consumer Financial Protection Bureau: The Consumer Financial Protection Bureau, a new agency created by the Dodd-Frank Act, is designed to protect the interests of consumers. For instance, it brings oversight of mortgages, credit cards and student loans under one roof. Previously, these practices were supervised and handled by various bank regulators.

Financial oversight: A 10-member council, led by the Treasury Secretary, will monitor threats to the financial system. It may decide which companies are so big or interconnected that their failure could upend the economy. If such a company falters, the government could liquidate it.

Mortgages: This area is a primary focus of the new law. For example:

♦ Prepayment penalties for adjustable-rate mortgages are prohibited.

♦ Lenders are required to disclose the maximum amount borrowers might pay on adjustable-rate mortgages.

♦ Loans that let homebuyers take out mortgages without documentation of income are banned.

♦ Bonuses for mortgage brokers and bankers based on the type of loans they make are prohibited.

Credit rating agencies: Agencies that give recklessly bad advice could be held legally liable for investor losses. Oversight will be handled by the Securities and Exchange Commission (SEC).

Fiduciary standards: Most financial services professionals are already held to a high "fiduciary standard" to act in a client's best interests. This high standard may be extended to stockbrokers after a study by the SEC.

Complex financial products: More transparency in trading is required for "derivatives" and other complex financial instruments. Generally, they have to be traded on a regulated exchange. However, banks can continue trading derivatives related to interest rates, foreign exchanges, gold and silver.

Risk retention: Some bad loans were sold into a secondary market and pooled as mortgage bonds. Thus, the risk associated with a bad loan was passed along to investors. Lenders must now retain at least 5% of the risk.

Executive compensation: This area has been a lightning rod for criticism of the financial services industry. Shareholders will be able to vote on executive pay packages. Oversight will be handled by the Federal Reserve.

Credit card fees: New limits will apply to the fees that banks can charge merchants for accepting debit cards. Also, merchants will be allowed to require a minimum $10 purchase on a credit card. Governments and colleges can set maximums for credit card payments. This could affect parents who charge tuition to earn frequent-flier miles or other rewards.

Credit scores: If you are denied a loan or otherwise have been hurt by your credit score, you can request an immediate free copy of your score.

Car loans: The Federal Trade Commission (FTC) may impose new rules to protect consumers from abusive auto-financing deals.

These are just some highlights of the new law. Obtain more information if you will be personally affected.

Noncompete Agreements: Tax Angles

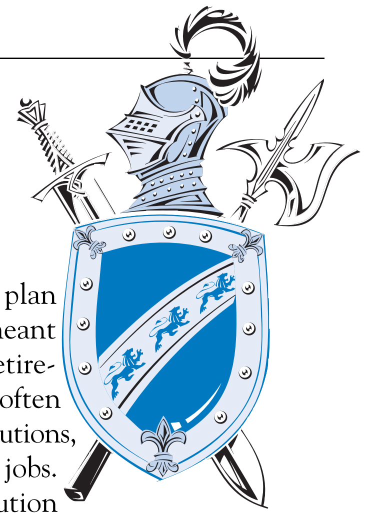
Generally speaking, the cost of acquiring an intangible business asset must be amortized over a period of 15 years.

New case: A partial owner of a crisis-management firm sold out his interest. The buyout included a $400,000 payment for a "covenant not to compete" spanning two tax years. But the IRS challenged a two-year write-off. **Result**: The Tax Court agreed with the IRS. The covenant arose from the acquisition of the business interest, so the 15-year rule applies.

This is a complex area of the tax law. Have a professional handle the details.

Guard Against Five 401(k) Mistakes

Potential pitfalls for retirement-savers



The 401(k) plan is the most popular retirement plan in the land. So there is a good chance that you, or your spouse if you are married—or maybe even both of you—are eligible to participate in this type of plan. If that's the case, you may want to avoid mistakes that have plagued individuals in the past. Here are five common examples:

Mistake #1: You sit on the sidelines. All too often people who are eligible to participate just say "no." But this is an opportunity to salt away money for the future without any current tax erosion. For 2010, the tax law allows you to defer up to $16,500 to your account, plus an extra $5,500 if you are 50 or older. What's more, your employer may "match" your contribution up to a stated percentage of salary. This matching contribution costs you zero out of pocket.

Mistake #2: You do not invest carefully. As with investments outside your plan, you should avoid too heavy a concentration in one particular offering. Other errors include over-diversification, such as scattering dollars in every possible mutual fund or other investment option. Try to find the proper balance. A logical approach is to allocate assets based on your current age, your expected retirement age, the amount you are contributing each year and your tolerance for risk. Of course, there are no absolute guarantees.

Mistake #3: You "rob" your plan early on. A 401(k) plan is meant to be a savings vehicle for retirement. However, participants often cannot resist taking out distributions, especially if they are changing jobs. As a general rule, a distribution made prior to age 59½ is subject to a 10% penalty tax on the taxable portion in addition to the regular income tax that is owed. **Note**: If you switch jobs and roll over funds from your 401(k) to an IRA or another qualified plan, the rollover is exempt from current income tax if completed in a timely fashion.

Mistake #4: You borrow money from your plan. Along the same lines, you should be discouraged from taking a loan from your 401(k). Even though you will effectively be paying yourself back, it will be more difficult to meet your objectives for retirement. You will not have access to the funds you could have earned if the principal had remained intact. Borrowing may be necessary in an emergency, but in most cases it should be viewed as a last resort.

Mistake #5: You don't seek assistance. Recent law changes encourage 401(k) participants to obtain advice within certain parameters. There is no need to do it all on your own. With professional guidance, you can sidestep the common pitfalls outlined above.

Facts and Figures

Timely points of particular interest

➡**Workers Gone Wild**—A supermarket bookkeeper got into an argument with a customer. When her supervisor sided with the customer, the bookkeeper threatened to punch the boss in the face. She was fired for insubordination even though she had twice been named "Employee of the Year." After examining the facts, the district court in Pennsylvania said the employer could follow its corporate policy. **Result**: The court has dismissed the case.

➡**Small-business Audits**—According to a new study by the Transactional Records Access Clearinghouse (TRAC), a nonpartisan research group, the IRS is focusing more audit time on small businesses. TRAC shows that the IRS has increased the number of hours spent on audits of companies with assets of less than $10 million by 30% since 2005, while the hours spent auditing corporations with assets of $250 million or more decreased by one third.

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