

WEALTH PLANNING GROUP UPDATE

# 2010 Year End Planning Considerations

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This paper will address the following:

- **Income Tax Forecast**
- **Tax Loss Harvesting**
- **Income/Deduction Timing**
- **Roth Conversions**
- **Charitable Gifting**
- **Estate Tax Updates**
- **Annual Exclusion Gifting**
- **Insurance Review**

## Tax Planning Considerations

### Ordinary Income, Capital Gains and Qualified Dividends Forecast

It is widely speculated that before the end of the year, Congress may extend the Bush tax cuts for all taxpayers for 2011 and 2012, including the 35% ordinary income rate and the 15% long term capital gain and qualified dividend rate. It is also possible, however, that Congress will do nothing, allowing the current law in effect to expire by 2011, or extend the tax cuts only for those taxpayers under a specific income limit. If Congress does not act, the ordinary income rate (including tax on dividends) will rise to as high as 39.6%, and the 20% long term capital gain rate under the prior law becomes effective again on January 1, 2011.

### Tax Loss Harvesting

With the stock market at recent highs, many clients have year-to-date gains in their portfolios. This is a welcome change from the end of 2008 which left many with capital loss carryovers. Tax loss harvesting (or tax loss selling) refers to adjusting the portfolio at year-end to recognize losses; these losses may offset current year gains and reduce the overall income tax liability.

Generally, if a client has both long-term and short-term transactions, each type is reported separately and netted separately. Net long-term gain or loss is then combined with net short-term gain or loss to arrive at an overall net capital gain or loss.

- If the overall total is a loss, then up to \$3,000 may be used to offset ordinary income. The remaining amounts retain their original short-term or long-term nature and carryover indefinitely.
- If the overall total is a gain, net short-term gains are taxed at ordinary income rates, and long-term capital gains are currently taxed at a preferred 15% rate.
- Losses in one category may reduce gains in the other category (net long-term losses may reduce short term gains, or net short-term losses may reduce long-term gains); this is the foundation for year-end tax planning centered on tax loss harvesting.
- The latest trade date to realize a capital loss is Friday, December 31.

### **Income/Deduction Timing Considerations**

Typical year end planning advice is to defer income and accelerate deductions, but in 2010 as in 2009 taxpayers may warrant a more thoughtful planning approach. The current Administration may support raising tax rates on the "wealthy," those whose income is over \$250,000 (married filing jointly) – thus, if clients believe tax rates are increasing, they may wish to reverse the usual advice and accelerate income and preserve deductions for those higher tax rate years.

- Taxable income can be lowered by accelerating deductions for IRA contributions, expenses from producing rental or royalty income, moving expenses, self-employed health insurance costs, interest on student loans, higher education expenses, alimony payments, etc.
- Maximizing deductions in the current year and deferring income to a later year may be an appropriate strategy for some clients. If applicable, note that some deductions are deductible for regular tax purposes but are not deductible for Alternative Minimum Tax ("AMT") purposes (i.e. prepaying state income taxes).
- Be aware of the "kiddie tax" which requires that all unearned income of dependent children under the age of 19 (or the age of 24 for a child that is a full-time student) over a certain limit is taxed at the parents' higher marginal rate.
- Maximize the allowable contribution to a 401(k) and an IRA as contributions to a 401(k) and an IRA are excluded from income. The maximum elective deferral for a 401(k) is \$16,500, or \$22,000 including catch-up for employees aged 50 and over. The IRA contribution limit is \$5,000, or \$6,000 including catch-up contributions.
- As the year draws to a close and while clients are reviewing portfolios for tax loss harvesting, it is a good idea to review with their tax advisor any stock options to determine whether to exercise or sell any options.

### **Roth IRA Conversion Overview**

Beginning in 2010, all taxpayers, including high income taxpayers, have the ability to convert a traditional IRA into Roth IRA. The ability to convert to a Roth since January 1, 2010 does not have an end date, thus taxpayers may convert for the foreseeable future. If taxpayers convert in 2010, there is an election to pay the tax liability over a two year period, one-half with the 2011 tax liability, and the balance with the tax 2012 liability, at the tax rates in effect in those years. Upon a Roth conversion, the entire pretax balance of a Traditional IRA (usually the entire IRA balance) is subject to income tax, but future withdrawals, for the next generation for example, will not be subject to income tax. The Roth opportunity, to pay tax now on a portfolio where assets may be depressed and future tax rates are likely to be higher than current levels, may be beneficial to taxpayers. Consider that once converted, a Roth IRA can be "re-characterized" or undone, especially where the IRA declines in value. The deadline for re-characterization is the due date of the timely filed return - October 17<sup>th</sup>, 2011 for a 2010 Roth conversion, and October 15, 2012 for a 2011 Roth conversion. It may be beneficial for some taxpayers to wait until January 2011 which would allow a longer look-back for re-characterization.

### **Charitable Contribution Planning**

As the year draws to a close, clients who anticipate making charitable gifts should begin planning their gifts. Donating low basis, highly appreciated securities that have been held greater than one year to

charity can provide an income tax deduction (subject to AGI limitations) for the fair market value of the property contributed, without incurring capital gains tax on the appreciation. Conversely, if the property has depreciated, the property can be sold to generate a capital loss, and the proceeds can be contributed to charity. Credit Suisse has created a donor advised fund solution for clients offered in conjunction with the Fidelity Charitable Gift Fund to provide a seamless donor advised fund solution. Below is a basic comparison of a Donor Advised Fund to a Charitable Foundation:

Description	Private Foundation	Donor Advised Fund
<b>Start Up Costs</b>	Substantive legal, accounting	Services are provided by the Fund
<b>Income Tax Deduction</b>	Cash: 30% of AGI Securities: 20% of AGI	Cash: Up to 50% of AGI Securities: Up to 30% of AGI
<b>Estate Tax Deduction</b>	100% of gift	100% of gift
<b>Excise Taxes</b>	2% of annual income	No Excise Tax
<b>Required Distribution</b>	5% of assets annually	No required pay-out
<b>Donor's Responsibilities</b>	Manage assets, keep records, prepare IRS reports, select charities, verify non-profit status, administer grants	Recommend charitable beneficiaries
<b>Public Exposure</b>	Foundation's IRS 990 Form is public record	Donor may maintain anonymity

## Estate Planning Considerations

### Estate Tax Update

As was the case last year, we again are waiting for Congress to consider comprehensive estate tax legislation. There is a good chance that if Congress passes estate tax legislation, whether this year or in the future, that legislation likely would retain the 2009 estate tax exclusion amount at \$3.5 million (or possibly \$4 million) and the estate tax rate at 45%. If left unchanged, the current law would allow an estate tax exclusion of just \$1 million and impose a 55% estate tax rate beginning January 1, 2011. Broader tax legislative changes such as GRAT modifications and the elimination of partnership valuation discounts between family controlled entities may also be addressed in such comprehensive tax legislation. Note that the gift tax rate in 2010 is 35%, compared to 45% in 2009, and 55% in 2011 and beyond – taxpayers contemplating lifetime gifts should consider the low 35% rate this year.

### Utilize the Annual Exclusion to Transfer Wealth

The annual exclusion provides a method of reducing taxable estates without incurring a gift tax. In 2010, gifts of up to \$13,000 per donee (\$26,000 for married couples) can be excluded from gift tax regardless of the relationship between the donor and the donee, thereby preserving the donor's \$1 million lifetime gift tax exclusion amount. Annual exclusion gifts can be made to an unlimited number of donees and can be made in many forms including funding a 529 plan, a custodial account, or other types of irrevocable trusts. And although the \$13,000 may seem like a minor amount, it is an efficient method of gifting and should be a component of a more involved wealth transfer program. In order to

take advantage of the 2010 annual exclusion, the gift must be completed by December 31, 2010 as gifts cannot be carried over from one year to the next.

- To lessen the planning considerations for 2011, consider making 2010 gifts prior to December 31, and making 2011 gifts shortly after the 1st of the year.
- If gift trusts are part of the wealth transfer program and annual exclusion gifts are utilized to make contributions to irrevocable trusts, such as insurance trusts (or ILIT's) make sure all necessary Crummey letters are sent out before year end. If these letters are not completed, gifts to the trust may fail to qualify for the annual exclusion.
- Every client should review his or her overall financial situation to confirm that the client's estate plan complements his or her current net worth, and is consistent with estate planning goals and objectives.
- As mentioned above, taxpayers contemplating making lifetime gifts should consider the low 35% rate this year in 2010, as opposed to the potential 45% or 55% next year.

### **Insurance Planning**

Perform a life insurance review. As a result of changes in actuarial tables and product developments in the insurance industry, many clients' existing life insurance policies may no longer be the best, most cost effective solution. Credit Suisse has contracted with an independent, third-party insurance provider to assist us by reviewing such policies and advise more generally on insurance needs. Please contact your Wealth Strategist and/or CS Insurance to discuss insurance solutions within the context of wealth planning, especially as it relates to income replacement and wealth transfers.

In addition to life insurance, other forms of insurance should be reviewed on a periodic basis, including:

- umbrella / excess liability coverage for catastrophic type liability coverage,
- property and casualty coverage on real estate and automobiles, and
- director and officer's insurance where applicable.

For more information please contact your regional Wealth Strategist to learn how the Wealth Planning Group can assist you.

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