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“To maximize tax benefits over time it is best to realize deductions and credits in years of higher income.”

With Halloween and Thanksgiving behind us, it is easy to see that the New Year will be here before we know it. While retailers have Holiday gift-giving on their minds, at Stoker Ostler we have year-end tax planning on ours. In the handful of weeks left in the 2009 tax year it is important to draw our clients' attention to some planning tips that may help save tax dollars.

To begin with, let me review some basic principals of tax planning. While the old rule in the industry used to be “delay taxes as long as possible,” the threat of rising tax rates changes this mantra to “take advantage of low tax rates.” Wherever you fall in the tax rate schedule, the goal is to fully use your lower rate brackets while taking advantage of deductions and credits to avoid hitting your highest bracket. With this in mind, let me review a number of strategies for reducing your overall tax burden.

Required Minimum Distributions

Most of you know by now that for 2009 there are no required minimum distributions from IRAs and many qualified plans. If you are currently in a high rate bracket you may be better off not taking a distribution if it is not needed to cover expenses. However, some of you may benefit from taking an unneeded distribution if it allows you to utilize the lower tax brackets. For example, I

recently worked with a client who did not need to take a distribution for 2009, but when we examined his 2009 tax projection we found that he would only be in the 10% tax bracket due to high itemized deductions. He has chosen to take an IRA distribution in order to take full advantage of the 10% and 15% tax brackets. While this will increase his tax liability for the current year, it will reduce his taxes over time.

Roth IRA Conversions

Taxpayers with modified adjusted gross income (MAGI) of less than \$100,000 for 2009 may choose to convert a traditional IRA or qualified plan to a Roth IRA. This is a taxable transaction, with ordinary income taxes owed on the amount of the conversion. For individuals wishing to increase their 2009 income to take advantage of low tax brackets a Roth conversion might be a good strategy. See my September newsletter for more information on Roth conversions.

While IRA distributions and Roth conversions increase current income, many clients—especially those in their highest earning years—are looking for ways to reduce taxable income. Fortunately, there are a number of strategies in the form of deductions and credits that can help.

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Contributions to Qualified Plans and IRAs

You may be able to reduce your taxable income by contributing to your retirement plan. Income contributed to an employer-provided qualified plan will not be included in taxable income in the current year (although payroll taxes will be deducted). Contributions to IRAs and self-employment retirement plans are deducted as adjustments to gross income. If you have not yet maximized your 2009 contributions to your qualified plan or IRA, now is a good time to do so.

If you have a 401(k), 403(b), or 457(b) plan, you may elect to defer up to \$16,500 for 2009 (\$22,000 if you are 50 or older) and have until December 31st to do so. (Self-employed individuals have until the due date of the return to fund their Keogh plans.) The deadline for funding traditional and Roth IRAs is April 15th. Only individuals with income less than \$55,000 (\$89,000 for joint filers) will be able to make fully deductible contributions to a traditional IRA if they are covered by a retirement plan at work. If the taxpayer is not covered by a plan—but his spouse is—then the income limit rises to \$166,000 for full deductibility. Individuals with income in excess of \$65,000 (\$109,000 for joint filers) will be unable to make deductible IRA contributions if covered by a plan at work. This limit rises to \$176,000 for married taxpayers whose spouse is covered by a plan. There is no income limit if neither the taxpayer nor spouse is covered by a plan at work. The IRA contribution limit for 2009 is \$5000 (\$6000 for those aged 50 and over) and applies to traditional and Roth IRAs. Self-employed individuals with SIMPLE IRAs can defer up to \$11,500 (\$14,000 for those aged 50 and over).

Charitable Deductions

You may be able to turn non-cash items into tax savings by donating them to a qualified charity.

To find out how much your donations may be worth, go to www.itsdeductible.com, the free online website by Intuit, the makers of Turbo Tax. Simply select your items from a list to find out how much you can deduct. Don't underestimate the value of your unused items. They can add up to substantial tax savings. Got a tennis racket that you no longer use? It could be worth a \$31 deduction. How about the stationary bike that you got for Christmas four years ago and stopped using a few months later? Potentially a \$218 deduction. Your retired briefcase could get you a \$28 deduction. Those favorite jeans that you haven't been able to wear since the birth of your last child might be worth a \$12 deduction. Depending on your marginal tax rate, donating these items may provide a significant tax benefit.

Remember that the IRS has become stricter in its substantiation requirements for charitable gifting. For any contribution of \$250 or more you must have written acknowledgment from the organization—including a description of the property contributed—to substantiate your donation. For charitable contributions of items valued at \$500 or more you must complete a Form 8283, Noncash Charitable Contributions, and attach it to your tax return. An appraisal generally must be obtained for noncash property worth more than \$5000.

Thinking about giving cash to charity? Think again. If you have stocks or mutual funds that have a low basis you can get extra tax savings by transferring the security directly to the charity. This allows you to avoid realizing the capital gain. Contact your favorite charity for instructions on giving in-kind gifts—they will be happy to help you with the transaction.

Speaking of low basis assets, IRA assets make great charitable gifts. Unless you made non-deductible contributions to your traditional IRA you will have a \$0 basis in the IRA. When you take distributions they will be 100% taxable at

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your marginal ordinary income tax rate. Many taxpayers reach 70 ½ and dread the required minimum distributions because they force the taxpayer into higher tax brackets. If you find yourself in that position, you can transfer IRA assets (up to \$100,000 annually) directly to your favorite charity and avoid including the transfer in your adjusted gross income (AGI). This can provide an added benefit if you are close to losing other tax benefits due to AGI limitations. (Note: You will not receive a charitable deduction for the transfer because you did not realize the income—it ends up being a wash).

Deductions and Credits Provided by the American Recovery and Reinvestment Act

In the May newsletter I summarized the deductions and credits newly available due to the American Recovery and Reinvestment Act of 2009. I won't go into details here, but don't forget that you still have a few weeks left to take advantage of these tax benefits for 2009:

Tax deduction for sales tax on new vehicle purchases. Limited to new vehicle purchases up to \$49,500. Subject to phase-outs for individuals with incomes between \$125,000 and \$135,000 (\$250,000 to \$260,000 for couples).

First-time homebuyer credit. While originally set to expire on November 30th, this credit was recently extended to include contracts signed by April 30, 2010. In addition to an up to \$8000 credit for first-time homebuyers, a credit of up to \$6500 is now available for long-time residents who are replacing their principal residence that they have owned and lived in for at least five of the previous eight years. The credit is phased out for individuals with income above \$125,000 (\$225,000 for couples). For more information on this credit go to <http://www.federalhousingtaxcredit.com/>.

Energy tax credits. Two energy credits offer benefits of up to 30% of the cost of energy efficient home improvements. For more information visit

the Department of Energy's website at <http://www.energy.gov/taxbreaks.htm>.

American Opportunity Tax Credit. Covers 100% of the first \$2000 of college expenses plus 25% of the next \$2000 for the first four years of college. Subject to phase-outs for individuals with income above \$80,000 (\$160,000 for couples). For more information, go to <http://www.irs.gov/newsroom/article/0,,id=205674,00.html>.

Bunching Income and Deductions

To maximize tax benefits over time it is best to realize deductions and credits in years of higher income. By offsetting income with deductions you may be able to keep from hitting the higher tax brackets. Individuals with low itemized deductions (meaning they are high enough to itemize, but not much over the standard deduction) may benefit by bunching itemized deductions into years of higher income and using the standard deduction in lower income years.

Certain other strategies, if taken advantage of by the end of the year, will improve your overall tax picture, although they don't produce immediate tax savings:

Making Use of Annual Exclusion Gifts

For clients who would like to make tax-free gifts to family or friends the maximum amount is \$13,000 per donee for 2009. This strategy can be enhanced by giving tax-wise gifts. For example, contributions to 529 college savings plans or Coverdell education savings accounts will provide tax-free growth for assets that will be used to fund education. While 529 plans can only be used for higher education, Coverdell accounts can be used to fund K-12 education.

One of the best uses of an annual exclusion gift might be funding a Roth IRA contribution for your child or grandchild. To qualify, the child must have earned income from a job. The Roth

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contribution is limited to the lesser of the child's earned income or \$5000, making it well within the annual exclusion limit. This is an especially good strategy for teens and young adults who have limited income and cannot afford to make their own Roth contributions, but who will benefit greatly from tax-free growth over a lengthy investment time horizon.

Flexible Spending Accounts

Now is a good time to check the balance of your flexible spending accounts. FSAs are designed to allow certain expenses, such as health care and dependent care, to be funded with pre-tax dollars. However, there is a hitch—unused account balances are forfeited at the end of the plan year. If your plan follows a calendar year (most do) you have a few weeks left to use up your account balance. If you have a balance remaining in your FSA now might be a good time to schedule a medical check up or some dental work.

State Tax Credits

Arizona taxpayers may also benefit from a **credit for contributions made or fees paid to public schools**. The credit is equal to the amount of contributions made or fees paid, up to a maximum of \$200 for individuals or \$400 for couples. To qualify, you must make contributions or pay fees to a public school for support of extra-curricular

activities or for character education programs. You need not have a child enrolled in school to receive the credit. Every Arizona taxpayer can choose to direct up to \$200 of his state taxes to support qualifying public school programs by making a contribution.

In addition to supporting public schools, Arizona taxpayers may receive a **credit for contributions to school tuition organizations** that provide scholarships or grants to qualified schools. This credit is equal to the amount contributed, up to \$500 for singles and \$1000 for couples. A qualified school is a non-governmental primary or secondary school located in Arizona, or a preschool for handicapped students located in Arizona. Some tuition organizations allow you to donate to a specific school and to suggest a recipient for the donation. Check with your neighbors and friends to see if their child might be able to benefit directly from your contribution. Arizona residents may benefit from both credits as long as they have a tax liability that equals or exceeds the credit amounts.

While planning your Holiday shopping, don't forget to plan on giving yourself a gift in the form of lower taxes. With a little bit of planning you may be able to use the last few weeks of 2009 to lower your tax liability. If you have any questions about anything discussed in this newsletter, don't hesitate to give us a call. We are happy to help you with your year-end tax planning.

THE GREATEST COMPLIMENT YOU CAN PAY IS THE REFERRAL OF FRIENDS & FAMILY.

Thank you for your confidence.

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