2010 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. Nothing is certain at this point! (At least until after the November elections).**

Nevertheless, you can take certain logical steps at year-end regardless of the way the tax winds blow.

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" below).**

Alternative minimum tax: Despite another bump in the exemption amounts for 2010, you still may be required to pay the alternative minimum tax (AMT). 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 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. **The energy credit is set to expire on December 31, 2010.**

Remember: This is only a general overview of several tax-planning techniques for individuals. Contact us for more specific information at (508) 755-3500.