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Mr. Smith

Dear Mr. Smith:

LAST-MINUTE MOVES THAT SAVE TAXES FOR 2009 AND BEYOND

Although there are only about four weeks left to go before the year ends, it's not too late to implement some planning moves that can improve your tax situation for 2009 and beyond. This letter reviews some actions that you can take before December 31st to improve your overall tax picture.

Make year-end gifts: A person can give any other person up to $13,000 for 2009 without incurring any gift tax. The annual exclusion amount increases to $26,000 per donee if the donor's spouse consents to gift-splitting. Anyone who expects eventually to have estate tax liability and who can afford to make gifts to family members should do so. Besides avoiding transfer tax, annual exclusion gifts take future appreciation in the value of the gift property out of the donor's estate, and shift the income tax obligation on the property's earnings to the donee who may be in a lower tax bracket (if not subject to the kiddie tax).

Observation: The estate tax was supposed to end for estate of decedents dying in 2010 but that appears unlikely. There is a serious move afoot in Congress to undo the repeal and keep the estate tax in force at the current exemption level of $3.5 million.

Gifts that qualify for annual exclusion: The gift tax exclusion generally is not available for gifts of future interests. However, transfers to minors under the Uniform Gifts to Minors Act or Uniform Transfers to Minors Act do qualify for the exclusion. Also, a gift made to or for the benefit of a minor qualifies for the exclusion if the gift property and its income will pass outright to the beneficiary on reaching age 21 (or to the minor's estate if he or she dies before age 21). Also, gifts to so-called Crummey trusts, which give the beneficiary a limited right of withdrawal, qualify for the annual exclusion.

Observation: Taxpayers doing gift tax planning should also take into any account any income tax implications. Under the Tax Code, a child subject to the kiddie tax pays tax at his parents' highest marginal rate on the child's unearned income over $1,900 (for 2009) if that tax is higher than the tax the child would otherwise pay on it. For 2009, a child is subject to the kiddie tax if either parent is alive at the end of the tax year; the child does not file a joint return for the tax year and (1) the child hasn't reached age 18 before the close of the tax year or, (2) the child's earned income doesn't exceed one-half of his support and the child is age 18 or is a full time student age 19-23.

Year-end gift checks: A gift by check to a noncharitable donee is considered to be a completed gift for gift and estate tax purposes on the earlier of:

(1) The date on which the donor has so parted with dominion and control under local law as to leave in the donor no power to change its disposition, or

(2) The date on which the donee deposits the check (or cashes it against available funds of the donee) or presents the check for payment, if it is established that:

... the check was paid by the drawee bank when first presented to the drawee bank for payment;

... the donor was alive when the check was paid by the drawee bank;

... the donor intended to make a gift;

... delivery of the check by the donor was unconditional; and

... the check was deposited, cashed, or presented in the calendar year for which completed gift treatment is sought and within a reasonable time of issuance.

Thus, for example, a $13,000 gift check given to and deposited by a grandson on Dec. 31, 2009, is treated as a completed gift for 2009 even though the check doesn't clear until 2010 (assuming the donor is still alive when the check is paid by the drawee bank).

Recommendation: Annual exclusion gifts shouldn't be postponed until year-end. If such gifts are made at the beginning of each year, their appreciation in value inures to the donee that much sooner, and greater family income tax savings can be achieved. Additionally, if the donor dies or becomes incapacitated during the year, the exclusion already will have been secured.

Increase withholding to help avoid estimated tax underpayment penalty: An employee may discover that their prepayments of tax for 2009 have been too small because, for example, their estimate of income or deductions was off and they underwithheld, too little was withheld as a result of the making work pay credit, or they failed to make estimated tax payments for unanticipated income, such as gains from sales of stock. To ward off or reduce an estimated tax underpayment penalty, the employee can ask their employer to increase withholding for their last paycheck or paychecks to make up or reduce the deficiency. They can file a new Form W-4 or simply request that the employer withhold a flat amount of additional income tax.

Increasing the final estimated tax payment for 2009 (due on Jan. 15, 2010) can cut or eliminate the penalty for a final-quarter underpayment only. It doesn't help with underpayments for preceding quarters. By contrast, tax withheld on wages can wipe out or reduce underpayments for previous quarters because, as a general rule, an equal part of the total withholding during the year is treated as having been paid on each quarterly estimated payment date.

Deplete health FSA accounts: Employees who participate in their employer's health flexible spending account ("FSA") should keep in mind that medical expenses reimbursed under the account generally must be incurred during the participant's period of coverage (normally 12 months) under the FSA. Although IRS has allowed employers to provide an additional 2 1/2 month grace period in which employees can incur expenses and still obtain reimbursements of these amounts, many employers have not availed themselves of this opportunity. As a result, an employee whose period of coverage ends on Dec. 31 should be sure to deplete his health FSA before the year's end (e.g., by getting new contact lenses) or they'll lose what's left in the account. Expenses are treated as having been incurred when the participant is provided with the medical care that gives rise to the expenses, and not when the participant is formally billed or charged for, or pays for, the medical care.

Observation: Employer reimbursements of amounts paid for nonprescription drugs (i.e., "over-the-counter" drugs, like antacid, allergy medicine, pain reliever, or cold medicine) are considered expenditures for medical care, and thus qualify for reimbursement, even though amounts paid for over-the-counter drugs are not deductible as a medical itemized deduction.

Qualified motor vehicle taxes: Unless Congress changes the law, for 2010, a taxpayer won't be able to deduct qualified motor vehicle taxes whether or not the taxpayer itemizes deductions. So if a taxpayer is intending to purchase a qualified motor vehicle soon, they should do it before year end. Provided the taxpayer meets certain conditions, it will assure them a deduction for any qualified motor vehicle taxes paid on the purchase whether or not they itemize and whether or not Congress extends the optional itemized deduction for sales tax in lieu of income tax, which also is scheduled to expire this year. Even if the optional sales tax deduction is extended as expected, the taxpayer would have to give up the itemized deduction for state and local income taxes to take advantage of it. By purchasing this year, the taxpayer can both deduct sales tax on a qualifying motor vehicle purchase and get an itemized deduction for state and local income taxes.

How it works: For purchases on or after Feb. 17, 2009 and before Jan. 1, 2010, the definition of taxes allowed as a deduction was expanded to include qualified motor vehicle taxes paid or accrued within the tax year. The deduction generally is allowed to itemizers and to those claiming the standard deduction.

Qualified motor vehicle taxes are state or local sales or excise taxes imposed on the purchase of a qualified motor vehicle. A qualified motor vehicle is a (1) passenger automobile, light truck or motorcycle the gross vehicle weight rating of which is not more than 8,500 pounds and (2) a motor home. The original use of the motor vehicle must begin with the taxpayer. Only taxes on that part of the qualified motor vehicle's purchase price not exceeding $49,500 may be deducted.

The amount of sales or excise taxes that may be treated as qualified motor vehicle taxes is phased out ratably for a taxpayer with modified AGI (MAGI) between $125,000 and $135,00 ($250,000 and $260,000 on a joint return).

Interplay with pre-2010 optional sales tax deduction for itemizers: The deduction for qualified motor vehicle taxes is not available to a taxpayer who elects to deduct state and local sales and use taxes in lieu of income taxes as an itemized deduction.

Caution: In comparing the optional sales tax and the new deduction, there are a few caveats. For purposes of the optional sales tax deduction, (1) if the rate of tax on motor vehicles exceeds the general sales tax rate, the deduction is limited to the general rate; and (2) there is no purchase price limitation or separate income limitation.

Interplay with AMT: The deduction for qualified motor vehicle taxes is allowed in computing the alternative minimum tax (AMT). This is to be contrasted with the optional itemized deduction for state and local sales and use taxes, which is not allowed in computing the taxpayer's alternative minimum taxable income.

Credit for hybrids and other environmentally friendly cars: In addition to obtaining a sales tax deduction, a taxpayer can claim a tax credit if before the year's end they buy and places in service certain new fuel efficient cars: qualified fuel cell motor vehicles, advanced lean-burn technology motor vehicles, qualified hybrid motor vehicles and qualified alternative fuel motor vehicles. A taxpayer can claim this credit even if the car isn't used in a trade or business or for the production of income. The most widely available type of these vehicles is the hybrid. However, the credit for a particular manufacturer's cars phases out—i.e., is reduced and eventually eliminated—for hybrids (and advanced lean-burn technology vehicles) that are bought in the calendar quarter after the one following that in which the manufacturer records the sale of its 60,000th vehicle. For the second and third calendar quarters after that in which the 60,000th vehicle is sold, taxpayers may claim 50% of the credit. For the fourth and fifth calendar quarters, taxpayers may claim only 25% of the credit. No credit is allowed after the fifth quarter.

In addition, two tax credits may be available to taxpayers in 2009 who purchase an electric vehicle. In certain cases, a taxpayer may qualify to claim both the new qualified plug-in electric drive motor vehicle credit, created by the Emergency Economic Stabilization Act of 2008 and the plug-in electric vehicle credit, created by the American Recovery and Reinvestment Act of 2009. However, a taxpayer can only claim one credit for the same vehicle.

Purchase of energy saving home improvements before year's end: It is still not too late to achieve tax savings by purchasing energy saving home improvements before year end as summarized below.

Nonbusiness energy property credit: In 2009 and 2010, a taxpayer can claim a credit equal to 30% of the sum of the cost of: qualified energy efficiency improvements to their home (e.g., energy-efficient windows, doors, insulation materials, and certain roofs) and residential energy property expenditures (e.g., high-efficiency heat pumps, air conditioners, water heaters, and stoves that burn biomass fuel), up to an aggregate amount of $1,500.

Residential energy efficient property: Beginning in 2009, there is no limitation on the 30%-of-cost credit amount for qualified solar electric property costs, qualified solar water heating property costs, qualified small wind energy property costs, and qualified geothermal heat pump property costs. The previous limitation on the credit amount for qualified fuel cell property costs—$500 for each 0.5 kilowatt of capacity—remains the same.

If you would like more details, please call me at your convenience. Piascik & Associates, P.C., provides premier tax, business, and financial services to a broad range of clients throughout the United States, Canada, UK, Germany and abroad. For more information, please visit www.piascik.com, or call Ryan L. Losi directly at (804) 228-4179.

Very truly yours,
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