



The essential tax and wealth
planning guide for 2010
*A year-round resource for
navigating change in today's
economy*

About our 2010 tax and wealth planning guide

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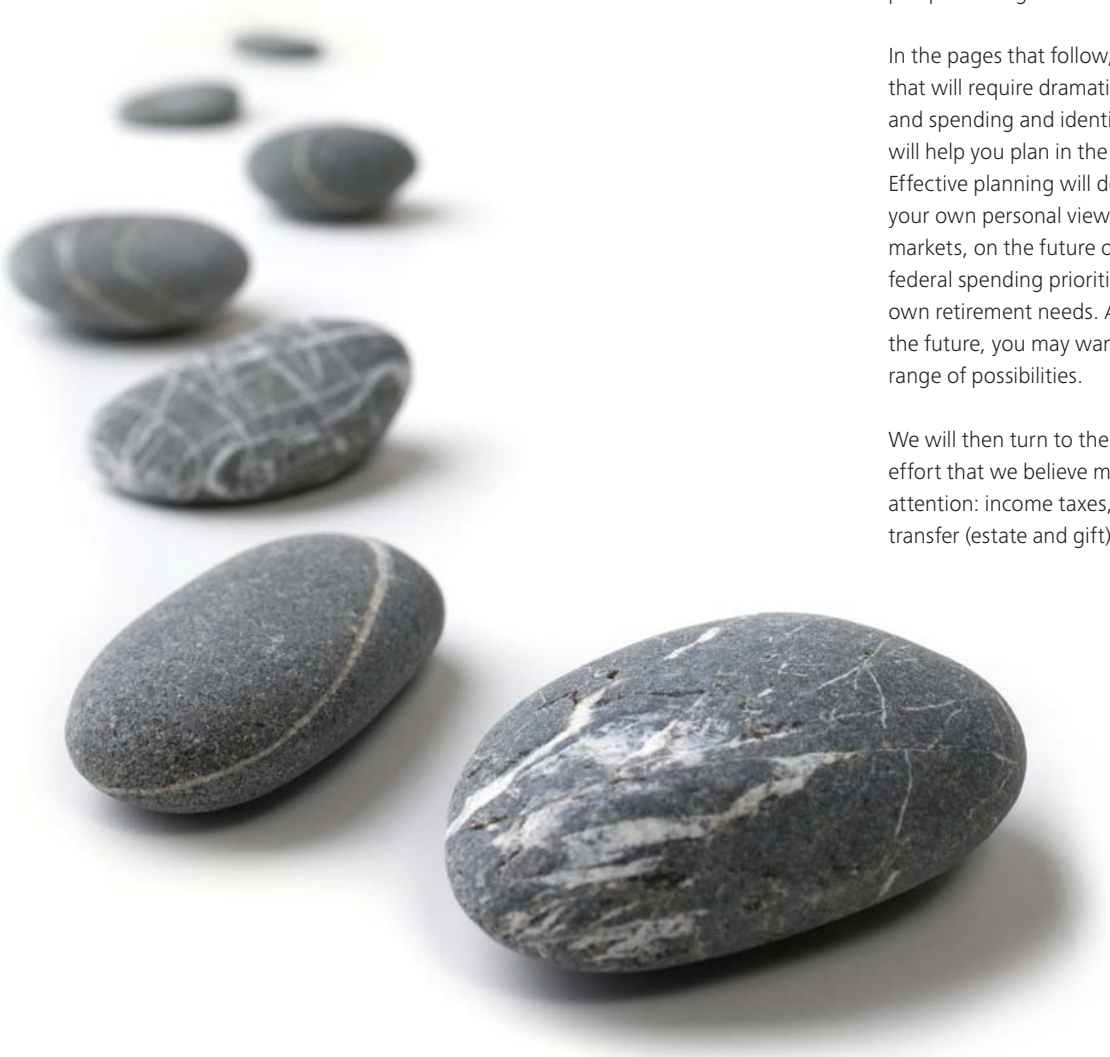
Introduction

At streamside on a summer afternoon, the world seems to pause momentarily as light reflects off the surface of water rolling and churning toward an uncertain future. Yet, beneath the sparkling surface inevitable forces are at work as water surges over rocks worn smooth by its unrelenting force into pools where trout lie in wait. Here, both opportunity and risk are present — with patience a prize may be landed, but inattention will yield at best an empty creel and at worst serious injury.

As debates over economic recovery, health care, and climate change swirl through Washington, conversation about personal income taxes and estate and gift taxes seems to have paused momentarily — albeit without the tranquility of a mountain stream. Nonetheless, we know that beneath the surface of this relative silence, inevitable forces are at work that will bring significant changes to personal wealth planning. While our readers need not pull on waders and boots for the work ahead, they will find that attention to detail and patience are required to prosper through the future challenges.

In the pages that follow, we will examine the forces that will require dramatic changes in federal taxes and spending and identify underlying realities that will help you plan in the context of uncertainty. Effective planning will demand that you develop your own personal views on our economy and the markets, on the future of taxes and tax rates, and on federal spending priorities that may influence your own retirement needs. Although no one can predict the future, you may want to test your plans under a range of possibilities.

We will then turn to the three major areas of planning effort that we believe most urgently demand your attention: income taxes, investments, and wealth transfer (estate and gift) taxes.



Income tax

Appropriately reducing or postponing the payment of federal, state, and local income taxes is a critical component of assembling the capital from which wealth grows. Although income taxes may seem hopelessly complex, effective tax planning begins with the concerns discussed below. These are:

- Understanding and managing the alternative minimum tax.
- Optimizing the tax benefits accorded capital gains and dividends.
- Planning charitable giving.
- Considering the impact of state taxes.
- Maximizing the benefits afforded by qualified retirement plans.

Investments

As of the writing of this guide, investors are faced with seemingly daily upheaval in the capital markets. We believe an investor's best defense is solid, up-front planning that relies on long-proven strategies in effective investment management. Some activities to incorporate in your planning include:

- Investing pursuant to an asset allocation.
- Considering the use of alternative investments to reduce portfolio volatility and risk.
- Monitoring your performance and holding your managers accountable.
- Thinking about the tax impact of asset allocation.
- Preparing future generations to make intelligent investment decisions.

Wealth transfer tax

Effective wealth transfer planning involves an ongoing process that requires monitoring, updating, and making adjustments throughout your lifetime as your goals, objectives, and circumstances change and evolve. The five major steps of the planning process include:

- Defining your family wealth transfer and charitable goals and objectives.
- Understanding the available wealth transfer tax exemptions, exclusions, and planning opportunities.
- Creating or updating your family wealth transfer and charitable transfer plan.
- Implementing the plan with due consideration to managing state and federal transfer taxes.
- Revisiting and fine tuning your plans and goals as your personal circumstances change.

The current environment

Looking beneath the surface

Successful fly fishing experiences start with a “reading of the stream” in which the angler seeks to understand the dynamics of the stream to identify the best opportunities and the most effective ways to exploit them. A similar reading of the budget and tax issues facing the country will help you succeed in personal tax and wealth planning.

As we suggested last year, the most salient feature in the current environment is the unsustainable nature of past tax and spending decisions. These, together with recent spending to address the faltering economy, have presented the country with spending commitments which, at current levels of taxation, will create deficits persistently higher than the rate of growth in the economy.

Recent Congressional Budget Office (CBO) projections underscore these fundamental questions about economic sustainability. According to CBO estimates, the federal government will record in fiscal years 2009 and 2010 its largest budget deficits as a share of gross domestic product (GDP) since World War II. If, over the long term, outlays continue to grow as projected without an increase in revenue at a corresponding rate, the country will witness a massive accumulation of debt, causing potential serious harm to the nation’s economy.

Broad agreement exists that the United States cannot grow its way out of these challenges. As a result, Congress and the White House must act to forestall these bleak outcomes through some combination of tax and spending changes. When they will act and what they will do is far from clear. The alternative, allowing an uncontrolled accumulation of debt, would raise the specters of inflation, declines in the value of the dollar, and reduction in the credit worthiness of federal debt obligations. In long-term planning activities, you may want to develop your own view as to the likelihood that inflation may become a critical consideration.

A focus on the wealthy

As Washington begins to address an array of serious issues, increasing taxes on higher income individuals has been repeatedly offered as a solution. This year alone, suggestions have been made that taxpayers generally with incomes in excess of \$250,000 should pay higher taxes in order to reduce the deficit, reform health care, shore up Medicare and social security, and restore fairness to the tax code. An overview of the principal proposals potentially affecting high-income individuals will help you make informed assumptions about where tax rates may be in the future so that you can make multi-year plans. Of course, these assumptions will need to be reviewed as events unfold.

Individual tax rates. President Obama and the Democratic majorities in Congress are committed to raising the ordinary income tax and capital-gains tax rates on higher-income individuals starting in 2011 to levels that prevailed during the Clinton Administration. They will be assisted politically and procedurally by the fact that without pre-emptive Congressional action before 2011, all of the 2001 and 2003 individual income tax rate reductions will expire.

President Obama, however, has repeatedly stated that he will preserve these benefits for lower- and middle-income individuals. But for married couples earning more than \$250,000 and singles more than \$200,000, he would:

- Reinstatement of the top two individual income tax rates (currently 33 percent and 35 percent) at their pre-2001 levels of 36 percent and 39.6 percent while maintaining the existing 10, 15, 25, and 28 percent tax brackets.
- Increase the qualified dividend income and long-term capital-gains rate from 15 to 20 percent for taxpayers in the top two tax brackets.
- Reinstatement of the personal exemption phase-out and itemized deduction limitation, which are scheduled to be eliminated starting in 2010.

In effect, the Obama plan would raise the top income tax rate, considering these phase-outs, to 41 percent from its 2009 level of about 35 percent.

Many individuals are basing their 2009, 2010, and 2011 tax and wealth plans on the assumption that these higher rates will take effect in 2011. In the *Income tax* section we discuss some of the planning steps that you will want to consider if you share this assumption.

In connection with health care reform, the House of Representatives has considered imposing a tax surcharge on high-income individuals. As this publication was being prepared, the fate of that proposal was uncertain given both strong opposition and the complexity of the health care reform debate.

Estate and gift taxes. Under current law, the estate tax rate is 45 percent on amounts exceeding the \$3.5 million exemption per individual or \$7 million per couple. Beginning in 2010, the estate tax is scheduled to be repealed for one year, before returning to the pre-2001 structure in 2011 (a top tax rate of 55 percent and an exemption of \$1 million per individual).

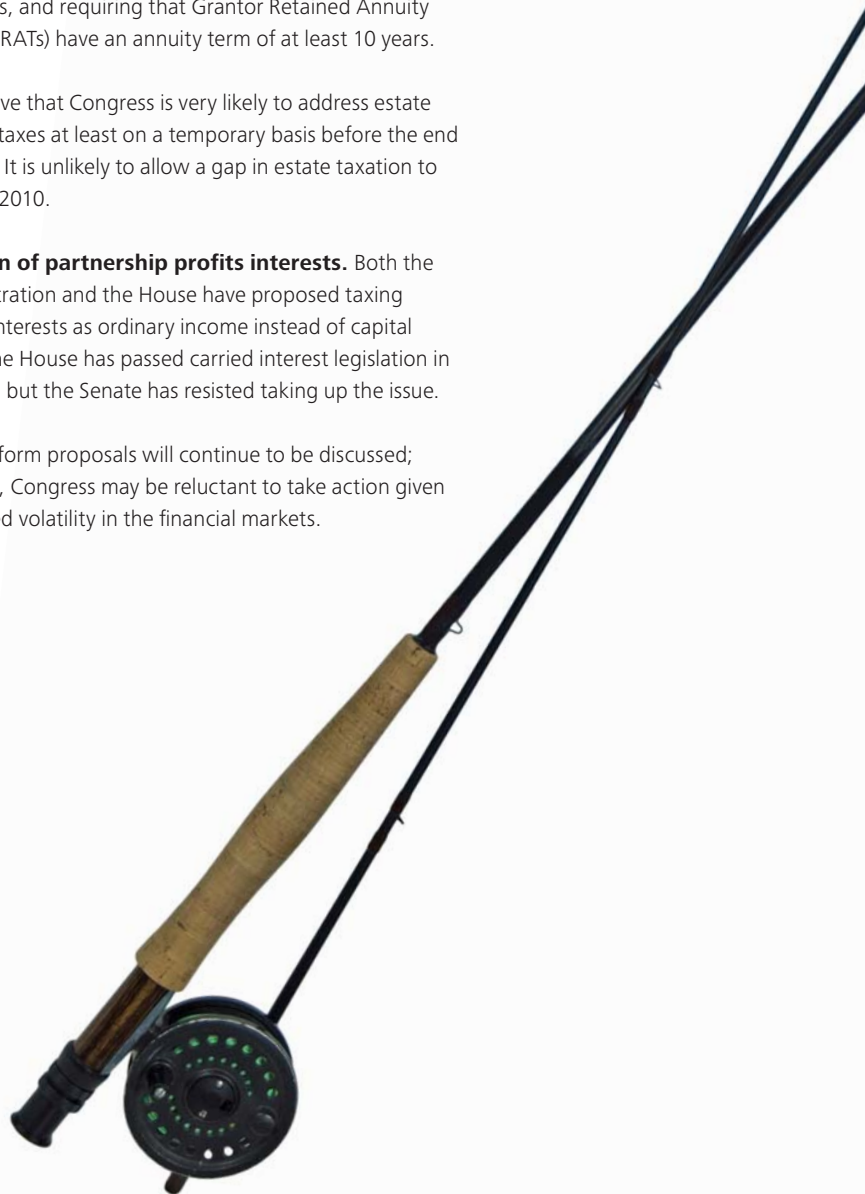
To avoid the estate tax disappearing in 2010 and reappearing in 2011, President Obama in his budget proposed making permanent the basic 2009 estate tax structure. Legislative proposals have recently been introduced that would retain the 2009 tax structure indefinitely or, in the alternative, significantly alter the exclusion amount, alter the rate structure, reintroduce the state death tax credit, recombine the gift and estate tax structures using a common exclusion amount, allow portability of an unused estate tax exemption from one spouse to another, retain the step-up in basis rules, and modify rules on valuation discounts. In short, there is no way to confidently predict what the estate tax rules will look like once the dust settles — with one exception: The tax will survive.

While Congress and the President may move to allow for more gifts and portability, the Administration also would like to address some perceived abuses. Loophole closers being targeted by the Administration include codifying the legal doctrine of “duty of consistency,” which requires consistent treatment of asset basis for both income and transfer tax purposes, limiting the use of minority interest discounts, and requiring that Grantor Retained Annuity Trusts (GRATs) have an annuity term of at least 10 years.

We believe that Congress is very likely to address estate and gift taxes at least on a temporary basis before the end of 2009. It is unlikely to allow a gap in estate taxation to occur in 2010.

Taxation of partnership profits interests. Both the Administration and the House have proposed taxing carried interests as ordinary income instead of capital gains. The House has passed carried interest legislation in the past, but the Senate has resisted taking up the issue.

These reform proposals will continue to be discussed; however, Congress may be reluctant to take action given continued volatility in the financial markets.



The current environment

The agenda is full

Before Congress and the Administration can turn their full attention to the individual income tax and the estate tax, they will have to resolve two other issues that are consuming most of the political energy in Washington: health care reform and climate change. The magnitude of the changes that these reforms could bring suggests that the value of companies will be influenced by how effectively they respond to a new set of issues and requirements. How and when Congress resolves these issues may be important to your investment decisions.

Health care reform, while not primarily about taxation, spawned a debate over how tax increases should fill the gap between cost savings achieved through reform and costs added by reform. In the simplest terms, this debate has raised two questions. First, should health care reform be financed with taxes related to health care or not? Second, who should bear the burden of those taxes?

Leaders in the House have decided to look primarily outside of the scope of health care issues to pay for reform. Notably, taxwriters in that chamber would place a large obligation on high-income earners to pay for the bill by introducing a graduated income tax surcharge, ranging from 1 percent to 5.4 percent, on singles and married couples with modified adjusted gross income (MAGI) above \$280,000 or \$350,000, respectively. The tax rate of 5.4 percent would apply to MAGI exceeding \$800,000 for singles and \$1 million for married couples. Health-care-specific tax revenue raisers would clarify the definition of “medical expenses” for medical savings accounts and reimbursement plans and impose mandates on individuals and employers for the purchase of health insurance, subjecting them to a tax penalty for noncompliance.

While negotiators in the Senate have considered several financing options that looked to health- and non-health-related revenue sources, lawmakers in that chamber have moved toward revenue options in the health arena. Though Senate negotiators have not reached consensus on financing options for health care reform, one of the leading contenders is a proposal to tax insurance companies that offer expensive health plans — or so-called “Cadillac” plans, which are sometimes offered to executives. Further, lawmakers are mulling imposing individual and employer mandates to encourage enrollment in insurance programs. A limit on the tax benefit provided by itemized deductions is another option, although it remains controversial and unpopular. Senate leaders have imposed a fall deadline to complete bipartisan negotiations on financing options. If the deadline passes without agreement, Democratic leaders will likely take more aggressive control over the legislative process, in an attempt to ultimately finish the reform efforts. The differences between how the House and Senate are leaning with respect to financing reform will likely lead to a difficult and contentious conference between the two chambers to reach a final agreement.

To date, the debate over legislation on climate change has not included active discussion of tax options by Congress. Although the sale of greenhouse gas allowances by the federal government under a cap-and-trade system would produce substantial revenue, current proposals are moving in the direction of softening the economic impacts of regulation by allocating the lion’s share of allowances for free.

Outlook for tax reform

As we noted previously, Congress must soon confront the expiration of the 2001 and 2003 tax cuts. This first aspect of tax reform must include not just income tax rates and the estate tax, but also the alternative minimum tax (AMT). Left as is, the AMT would rapidly become the tax base for the vast majority of middle-class taxpayers over the next decade. Some would say that this is acceptable as a backdoor approach to a flat tax. In reality, however, the AMT results almost entirely from two things: having children and paying state and local taxes.

The second aspect of tax reform will be consideration of corporate income taxes. President Obama has proposed far-ranging increases on U.S. multinational corporations. At the same time, a growing consensus in Washington supports a substantial reduction in corporate income tax rates. Finding agreement on a new set of corporate tax rules will be challenging and may not happen before the midterm elections in 2010. When corporate tax reform does occur, it is unlikely to produce a significant net increase in taxes.

Even if these waves of reform occur with respect to individual and corporate income taxes, Congress likely will not have enough revenue to do all that we ask of the federal government. That will force consideration of an additional federal levy in the form of some kind of a consumption tax. The question will be whether the tax will be a broad-based consumption tax burdening the purchase of most goods and services or whether it will be more narrowly focused on specific forms of consumption such as consumer goods, energy, or carbon.

Planning in uncertain times

The potentially dramatic level of the changes we see lurking below the surface creates unparalleled uncertainty for individual tax and wealth planning. It also can create opportunity for those who address the uncertainty head on.

Continue to plan; work with what you know.

In the face of such uncertainty, it is tempting to do nothing on the grounds that it is too hard to know what to do. Of course, in tax and wealth planning, a decision to do nothing is still a decision and likely a bad one. We believe significant tax changes will occur, but until change comes, taxpayers will find that disciplined planning under present law produces real benefits. This is particularly true as the possibility of tax rates increasing in 2011 becomes more certain; thus, planning for those rate changes becomes more meaningful. In addition, many of the benefits under existing law are likely to continue. For example, while capital-gains tax rates may be increased modestly, the basic structure that results in a significant advantage for

long-term capital gains will continue. Similarly, there is no basis to believe that Congress and a new president would restrict or repeal existing retirement savings vehicles.

Be wary of quick answers and simple advice.

Tax legislation never concludes in the manner in which it starts. The U.S. and global economies and our governmental processes are highly complex, as are the structures, instruments, and businesses to which a tax law must apply. Even simple tax proposals evolve and change during the legislative process. Before taking action in response to a potential change, taxpayers should completely analyze a proposed transaction and alternative outcomes. For example, while selling an asset to avoid a higher capital-gains tax in the future may make sense in some cases, it may be costly in others.

A planning decision will depend on the amount of gain to be recognized relative to the asset's fair market value, the cost of the initial and anticipated subsequent transactions associated with the plan, the expected return on the asset, and the expected increase in tax rates. There is no simple, quick, or uniform answer.

Watch for opportunities and know your risks.

The mere discussion of dramatic tax changes and new taxes can influence markets. Continuing uncertainty over the long-term outlook for the federal budget influences financial markets and the value of the dollar. As an investor, you should work to be informed about significant tax and nontax reforms and position your portfolio in a manner consistent with your conclusions about how changes will affect investment opportunities.

Income tax

Analyzing income tax effects may seem complex and the laws are continuously changing, but effective tax planning focuses on certain key elements that are discussed further in this section.

Recently enacted tax law changes affecting individuals

Jobs Growth and Tax Reconciliation Act of 2003

Reduction of the five-percent capital gain/qualified dividend rate. Beginning in tax years after 2007, long-term capital gains and qualified dividend income are taxed at zero percent for taxpayers in the 10- and 15-percent tax brackets.

Small Business and Work Opportunity Tax Act of 2007

Expanded kiddie tax. Beginning in 2008, the kiddie tax is expanded to apply to any child who is under 19 years old or is a full-time student over the age of 18, but under age 24. The kiddie tax will not apply to these children who have earned income that exceeds half of their support for the year.

Mortgage Forgiveness Debt Relief Act of 2007

Exclusion of principal residence gain for post-death sale by surviving spouse. Beginning in 2008, a surviving spouse who has not remarried and who sells a principal residence within two years of the spouse's death can exclude up to \$500,000 in gain on the sale. The new provision effectively provides surviving spouses with the same benefit that is normally available to married persons filing jointly.

Exclusion of income from discharge of indebtedness on principal residence. Income attributable to cancellation of indebtedness related to a principal residence is excluded from tax. Debt for this purpose is capped at \$2 million, and the amount excluded from income shall reduce the basis of the residence, but not below zero. The exclusion applies to income associated with debt cancelled before January 1, 2010.

Economic Stimulus Act of 2008

Increased IRC Section 179 limits and bonus depreciation. For taxable years beginning in 2008, the maximum amount that a taxpayer may expense of the cost of qualifying property (e.g., generally tangible personal property or computer software acquired new from a third party for use in a trade or business) under IRC Section 179 is raised from \$128,000 to \$250,000. The amount expensed under Section 179 is reduced by the amount by which the cost of qualifying property placed in service during the year exceeds \$800,000 (previously \$510,000).

For 2008 only, taxpayers are allowed an additional first-year depreciation equal to 50 percent of the adjusted basis of qualified property for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is allowed for both regular and alternative minimum tax (AMT) purposes.

Food, Conservation, and Energy Act of 2008

Conservation easements. The opportunity to contribute charitable conservation easements, subject to the 50-percent adjusted gross income (AGI) limitation, is extended through 2009.

Housing and Economic Recovery Act of 2008

Exclusion on gain on sale of principal residence not to apply to nonqualified use. Gain from the sale of a principal residence allocated to periods of nonqualified use, such as rental use, is not excluded from taxable income. The change applies to sales and exchanges after December 31, 2008.

Emergency Economic Stabilization Act of 2008

Alternative minimum tax relief. This act extends the ability to use nonrefundable personal credits against the AMT. It also accelerates the ability to use the long-term unused minimum tax credit, which provides benefit to AMT taxpayers (including taxpayers who recognized AMT income by exercising incentive stock options (ISOs) in which the stock subsequently lost value).

Also, outstanding taxes, interest, and penalties as of October 3, 2008, that are attributable to the AMT adjustment for ISOs for tax years before 2008 are abated. The AMT credit for 2008 and 2009 may be increased by one-half of the amount of any interest and penalty paid before October 3, 2008, on account of the application of the minimum adjustment for ISOs.

Expiring provisions. Among others, the Act extended through 2009 the following expiring tax provisions:

- Itemized deduction for state and local general sales taxes.
- Tax-free distributions from individual retirement plans for charitable purposes.

The income exclusion related to discharged debt associated with a principal residence is extended to apply to debt cancelled before January 1, 2013. (The exclusion was originally enacted by the Mortgage Forgiveness Debt Relief Act of 2007, see above.)

Mandatory broker basis reporting. Brokers will be required to report the cost basis for transactions involving publicly traded securities. Specifically, brokers will have to maintain records showing their clients' adjusted basis in sold securities and whether gain from the sale is long or short term, and report that information to customers and the IRS. The new reporting mandate will apply to securities acquired on or after the effective date, which varies based on the type of security. For stock, the effective date of applicability of this new reporting rule is January 1, 2011, for mutual funds, January 1, 2012, and for other securities, January 1, 2013.

Offshore deferred compensation. Nonqualified deferred compensation paid by a nonqualified entity, or a so-called "tax indifferent party" will be currently taxed when there is no substantial risk of forfeiture of the recipient's rights to the compensation. A nonqualified entity can include certain foreign corporations and domestic and foreign partnerships that have tax-exempt partners.



Income tax

The change is effective for deferred amounts that are attributable to services performed after December 31, 2008. Amounts attributable to services performed before December 31, 2008, to the extent not previously included in income before 2018, are includible in the later of (1) the last taxable year beginning before 2018, or (2) the taxable year in which there is no longer a substantial risk of forfeiture as defined in this Act.

Executive compensation. For financial institutions that participate in the government's Troubled Asset Relief Program (TARP), new restrictions will apply to compensation paid to certain corporate executives. While the restrictions primarily apply to the employer, they may have indirect implications to the executives themselves. For example, some executives may be subject to an excise tax on golden-parachute payments.

American Recovery and Reinvestment Act (ARRA) of 2009

AMT relief. Exemption amounts are increased slightly above 2008 levels for 2009 to \$46,700 for individuals and \$70,950 for married filing jointly from their previous levels of \$46,200 and \$69,950. Nonrefundable personal credits, such as dependent care credit and tuition tax credit, can be used against AMT for 2009.

Making Work Pay Credit. For 2009 and 2010, individuals will receive a Making Work Pay Credit. The credit is equal to the lesser of \$400 for individuals and \$800 for couples, or 6.2 percent of the taxpayer's earned income, and is refundable even if the taxpayer otherwise has no income tax liability. The credit phases out as an individual's modified AGI increases from \$75,000 (\$150,000 for married taxpayers filing jointly) to \$95,000 (\$190,000 for married taxpayers filing jointly).

American Opportunity Tax Credit. The existing Hope Scholarship Credit for qualified tuition expenses is replaced with the American Opportunity Tax Credit for 2009 and 2010. The credit provides a benefit of up to \$2,500 per student per year and applies to 100 percent of the first \$2,000 of qualified expenses and 25 percent of the subsequent \$2,000. The credit is refundable up to 40 percent and is allowed to reduce regular and AMT

liabilities. The credit is phased out for taxpayers with an AGI between \$80,000 and \$90,000 (\$160,000 and \$180,000 for married taxpayers filing a joint return).

Deduction for new car sales and excise taxes.

Nonitemizers can take a standard deduction on the purchase of qualifying motor vehicles for state sales and excise taxes although itemized deductions are also allowed. The deduction cannot exceed the first \$49,500 of the purchase price and will be phased out from \$125,000 to \$135,000 of AGI for singles and \$250,000 to \$260,000 for married taxpayers filing jointly. The deduction is allowed for both regular tax and AMT and is applicable for purchases made on or after February 17, 2009, and before 2010.

First-time homebuyer credit. The first-time homebuyer credit, originally enacted as part of the Housing and Economic Recovery Act of 2008, provides an \$8,000 refundable tax credit to qualified homebuyers through December 1, 2009. (The credit was limited to \$7,500 for qualifying purchases after April 8, 2008, and before January 1, 2009.) The credit phases out for high-income taxpayers and generally is repaid to the government ratably over 15 years. This repayment period is accelerated if the home is disposed of or ceases to be the taxpayer's primary residence during the 15-year period. The repayment clause has been waived for houses purchased after December 31, 2008, but before December 1, 2009. If a home purchased during that period is sold or the homeowner ceases to use the property as his or her principal residence within 36 months after the date of purchase, the recapture clause described above will still apply.

For homes purchased after December 31, 2008, and before December 1, 2009, the taxpayer can elect to treat the purchase as having occurred in 2008. This provision will allow the taxpayer to accelerate use of the credit for homes purchased in 2009.

Energy incentives. The Act provides a number of provisions intended to promote the purchase of nonbusiness energy-efficient residential property by significantly decreasing the net cost of that property to the taxpayer. It also modifies and provides new incentives for alternative fuel vehicles and plug-in electric drive vehicles. See *Other planning considerations* at the end of the guide.

Bonus depreciation. Extended for one additional year is the 50-percent bonus depreciation enacted as part of the Economic Stimulus Act of 2008 (see above).

As a result of this one-year extension, the 50-percent bonus depreciation generally will be available for qualified property the original use of which commences with the taxpayer and which is placed in service during 2008 or 2009 (2010 in the case of certain longer-lived property).

Temporary extension of net operating loss (NOL) carryback for small business. Small businesses, with average gross receipts of \$15 million or less, have the option to elect a three-, four- or five-year NOL carryback period for losses arising in 2008. This extended carryback election applies to either:

- NOLs arising in a taxable year ending in 2008.
- NOLs arising in a taxable year beginning in 2008 if elected by the taxpayer.

Extension of enhanced small business expensing (Section 179). The increased Section 179 expensing limit of \$250,000 and investment phase-out of \$800,000 enacted by the Economic Stimulus Act of 2008 is extended through 2009.

Temporary reduction of S corporation built-in gains. holding period. The recognition period for S corporation built-in gains is temporarily reduced to seven years (from the current 10 years) for taxable years that begin in 2009 and 2010.

Section 1202 small-business stock exclusion. The percentage exclusion for gain on the sale or exchange of qualified small-business stock held for at least five years is increased from 50 percent to 75 percent for acquired stock issued after February 17, 2009, and before January 1, 2011. Current limitations on the amount of gain excluded under this provision (the greater of 10 times the taxpayer's basis in the stock or \$10 million) are retained. This provision is limited to individual investments and not the investments of a corporation.

Parity for qualified transportation fringe benefits.

The exclusion threshold is increased for employer-provided transit and vanpool benefits from its current \$120 per month to \$230 per month (indexed annually for inflation). It is effective for the months beginning on or after February 17, 2009 through December 31, 2010.

Tax rates

Income tax rates. For 2009, tax rates remain unchanged, ranging from 10 percent to 35 percent.

Underpayment penalties. Federal law requires the payment of income taxes throughout the year as the income is earned. This obligation may be met through withholding, making quarterly estimated tax payments, or both. The penalty for underpayment is calculated as interest on the underpaid balance until it is paid, or until April 15, 2010, whichever occurs first.

For 2009, individuals will not be subject to an underpayment penalty if the balance due on their federal tax return (total tax liability for the year, less withholdings) is \$1,000 or less. If the balance due is more than \$1,000, the taxpayer will be subject to a penalty unless 2009 withholdings and estimated tax payments equal 90 percent of the 2009 tax liability, 100 percent of the 2008 tax liability (110 percent if 2008 AGI exceeds \$150,000), or 90 percent of the 2009 tax liability, based on quarterly annualized year-to-date income.

Reduced minimum payments for qualified individuals.

Starting in 2009, estimated tax payments of qualified individuals may be based on 90 percent of the 2008 tax liability. An individual is a qualified individual if 2008 AGI is less than \$500,000, and more than 50 percent of 2008 gross income is income from a small business (defined as a business that employed fewer than 500 employees on average during the calendar year that ends with or within 2008). Individuals also must consider any underpayment rules imposed by their state(s) of residency and/or local and nonresident state tax authorities.

Income tax

2009 Tax Payment Method	Cumulative amount of estimated taxes to be paid				Due date			
	April 15, 2009	June 15, 2009	Sept. 15, 2009	Jan. 15, 2010				
Current year's tax or annualized income method	22.5%	45%	67.5%	90%				
Prior year's tax – safe harbor for qualified individuals	22.5%	45%	67.5%	90%				
Prior year's tax – safe harbor for AGI of \$150,000 or less	25%	50%	75%	100%				
Prior year's tax – safe harbor for AGI over \$150,000	27.5%	55%	82.5%	110%				

The above table illustrates the amount required to be paid (cumulatively) for 2009 taxes under each method by each date for calendar-year taxpayers.

Planning tip # 1: Income tax withholdings are considered paid equally throughout the year, even if the withholdings are made near the end of the year. If you anticipate that you have underpaid your estimated taxes for 2009, consider adjusting withholdings for the remainder of the year to avoid penalties for underpayment of estimated taxes.

Planning tip # 2: In certain circumstances, supplemental wages (e.g., bonuses, commissions, overtime pay, etc.) may be subject to a flat 25-percent withholding rate. If this rate is different from your normal withholding rate, be sure to factor the different rate into your estimated tax calculations. Similar to withholding on regular wages, taxpayers may increase the withholding amount on their supplemental wages to avoid penalties for underpayment of estimated taxes. Supplemental wages in excess of \$1 million are subject to a 35-percent withholding rate.

Planning tip # 3: If you anticipate being liable for underpayment penalties on estimated tax, you may consider taking an indirect rollover distribution from a traditional or Roth IRA account during the year of underpayment. If an indirect rollover of an IRA occurs,

the trustee of the IRA is required to withhold 20 percent of the funds distributed as a prepayment of federal income tax unless you elect not to have federal taxes withheld on Form W-4P. You may also elect to have an additional amount withheld from the distribution by providing the trustee of the IRA with Form W-4P. By triggering sufficient withholding tax, you can “cure” prior underpayments of estimated tax and avoid or reduce penalties. As long as you re-deposit the gross amount of the IRA distribution to another IRA within 60 days, no adverse tax consequences result from the rollover, provided you meet the once-per-year rollover limitation.

Overpayment of estimated taxes. Just as a taxpayer should avoid underpaying estimated taxes and incurring a penalty, a taxpayer also should avoid overpaying estimated taxes. Overpaying taxes is the equivalent of providing an interest-free loan to the government. You may receive a refund eventually, but you have lost the opportunity to have the money working for you.

Planning tip: If you anticipate that estimated taxes have been overpaid (or withholdings have been too high during the year), consider reducing withholdings during the remainder of the year to create an early refund. Certain restrictions apply with respect to the number of allowances that may be claimed, which will affect the minimum amount that can be withheld;

therefore, check with your tax advisor before submitting a new W-4 to adjust your withholdings for 2009. Also, estimate withholding for 2010 and file a new W-4 with your employer, if necessary.

Recognition of compensation income. Depending on your situation, you may be able to time the receipt of commissions, bonuses, or billings. Income recognition timing is not easy, however. You need to consider the time value of money, the impact that acceleration might have on various deductions, credits, your projected income tax rate in both years, and other nontax financial factors. There are several income-recognition techniques you may consider.

Planning tip # 1: Income is usually taxable to individuals in the year of receipt. In most cases, therefore, deferring income into 2010 will defer the associated tax. Consider delaying the receipt of an annual bonus until shortly after December 31, or waiting until January to bill for services. Check with your tax advisor prior to engaging in this type of planning to be sure you are not running afoul of constructive-receipt rules, which treat income as received even though you do not have cash in hand, or subjecting the income deferred to the very stringent Section 409A rules imposed on nonqualified deferred compensation. Also, check with your tax advisor to determine whether you may be subject to AMT in either year, as this may affect your ability to benefit from such a deferral strategy.

Planning tip # 2: Analyze opportunities to make a “Section 83(b) election” on restricted stock to convert ordinary income to capital gains. Section 83 of the Internal Revenue Code imposes ordinary income tax on property received as compensation for services as soon as the property becomes vested and transferable. If you receive eligible property (such as restricted stock), within 30 days of receiving the property, you can elect under Section 83(b) to recognize immediately as income the value of the property received and convert all future appreciation to capital-gains income, and all future dividends on the stock to dividends qualifying for the reduced 15-percent rate. Keep in mind, though, that making the election comes with a risk — if you make

the election and the stock never vests or it depreciates in value, you cannot “undo” the election at a later date, and your choice to recognize the income immediately may not provide the anticipated benefit. Careful planning is required to make sure you comply with strict rules and are able to properly weigh the benefits against the risks. Consult with your financial advisor before making this election.

Tax rates on dividends. A lower tax rate continues to apply to qualified dividends through 2010. The tax rate was decreased to 15 percent (five percent for taxpayers in the 10-percent and 15-percent tax brackets) for qualified dividends received after December 31, 2002. For taxpayers in the 10-percent and 15-percent tax brackets, the rate drops from five percent to zero percent for qualified dividends received in 2008 through 2010.

“Extraordinary” dividend income. The receipt of “extraordinary” dividends may cause unexpected tax results. Extraordinary dividends are typically the result of larger-than-normal dividends and/or a very low basis in the stock.

Dividends are considered “extraordinary” if the amount of the dividend exceeds 10 percent of the shareholder’s adjusted basis in the stock (five percent if the shares are preferred). All dividends with an ex-dividend date within the same 85 consecutive days are aggregated for the purposes of computing whether this threshold is met. Individuals who receive extraordinary dividends and later sell the stock on which the dividends were paid must classify as a long-term capital loss any loss on the sale, to the extent of such dividends. This rule applies regardless of how long the stock was held. Thus, for the investor who anticipated receiving short-term capital loss treatment on the sale, presumably to offset short-term capital gains, unexpected tax consequences may result. Absent this rule, a taxpayer who had already realized a short-term capital gain could buy a stock that was expected to pay out large dividends, hold the stock only long enough to receive the dividend, and then sell the stock at a loss to offset the short-term capital gain while enjoying favorable tax rates on qualified dividends.

Income tax

Planning tip # 1: Investment interest expense is only deductible to the extent of current-year net investment income. Dividends that are taxed at the 15-percent (or zero-percent) reduced rate are not treated as investment income for purposes of this calculation; therefore, you should consider electing to tax a portion of qualified dividends (or capital gains) at ordinary income rates to maximize use of the investment interest deduction. You may elect to recognize just enough of the qualified dividends to be taxed at ordinary income tax rates to offset investment interest expense and allow the remainder of qualified dividends to be taxed at the lower 15-percent rate (or zero-percent rate for lower-income taxpayers). Alternatively, you should consider whether carrying over an investment interest expense into a future year is more advantageous than electing to recognize qualified dividend income (and/or capital gains) as ordinary income for a current-year offset. If you have paid investment interest expenses and received dividend income or capital gains in 2009, you should discuss the possibility of making this election with your tax advisor.

Planning tip # 2: Some margin accounts allow a broker to borrow shares held in the margin account and return the shares at a later date. In practice, the broker borrows shares from a pool of investors in order to lend the shares to another investor to execute a short sale. For tax purposes, payments that are made while the shares are borrowed out are considered "payments in lieu of dividends," rather than dividends, and thus will not qualify for the lower 15-percent rate (or zero-percent rate for lower-income taxpayers). Unless your broker already has notified you of its policies regarding share borrowing, consider consulting with your broker to see whether it is the broker's policy to borrow shares from noninstitutional investors. In certain cases, an investor may want to transfer dividend-paying shares into a cash account or place a restriction on the broker's ability to borrow the shares. Alternatively, an investor may want to have the ability to call back shares of stock before the dividend date so that he or she will be the owner of the shares on the dividend record date.

Planning tip # 3: Taxpayers interested in family wealth planning can consider gifting assets that are expected to pay dividends to family members who are in lower tax brackets. As noted above, taxpayers in the highest four tax brackets are currently taxed at 15 percent on qualified dividends, whereas taxpayers in the lowest two brackets are taxed at zero percent. You should remain mindful of the kiddie tax rules discussed below.

Planning tip # 4: In order to qualify for the reduced rate of 15 percent, the underlying stock upon which a dividend is paid must be held for at least 61 days during the 121-day period, beginning 60 days before the ex-dividend date (91 days of the 181-day period for preferred stock). The shares must not be subject to a hedging transaction during this time period in order to qualify; therefore, if you regularly engage in hedging transactions or other derivative transactions, you may want to consider more complicated investment techniques, such as selling a qualified covered call, in order to take advantage of the lower rates.

The kiddie tax. Originally enacted to prevent the transfer of unearned income from parents to their children in lower tax brackets, the so-called kiddie tax targets investment income earned on investments in the name of a child, taxing such income at the same rates that apply to their parents. For 2009, the kiddie tax may apply if the child's investment income exceeds \$1,900. For tax years beginning in 2008, the kiddie tax has been expanded to include: (1) all children under age 19 and (2) full-time students under age 24. Many different segments of the population will be affected by the extension, including young college students who previously paid their tuition with proceeds from the sale of investments in accounts set up by their parents. Note, however, that beginning in 2008, the kiddie tax does not apply to a student over age 17 who has earned income that accounts for more than half of the student's support.

Capital-gain rates. The reduced long-term capital-gain rates will be effective through 2010. For taxpayers in the highest four income tax brackets, the long-term capital-gain rate is 15 percent. For tax years beginning in 2008-2010, the five-percent maximum capital-gain tax rate will drop to zero percent. After 2010, the zero-percent



long-term capital-gain tax rates will increase to 10 percent for those in the 10- and 15-percent tax brackets and the 15-percent long-term capital-gain tax rate will increase to 20 percent for all other taxpayers, barring Congressional action. Gains from installment sales are taxed at the rate in effect on the date an installment payment is received. Certain sales of capital assets do not qualify for the lower capital-gain rate. Collectibles remain subject to a 28-percent maximum rate. Unrecaptured Section 1250 gain on real estate is subject to a 25-percent maximum rate. Small-business stock is still subject to the 50-percent exclusion and the net is taxed at 28 percent.

Capital gains and capital losses. The decision to sell capital assets should be based on economic fundamentals, together with your investment goals; however, you should also consider the tax aspects. For taxpayers in the highest four tax brackets (35 percent, 33 percent, 28 percent, and 25 percent), current law generally provides a 15-percent rate on assets held for more than one year; thus, for those in the highest tax bracket, a 20-percent rate differential exists between short-term capital gains (which are taxed at ordinary income rates) and long-term capital gains. Pay attention to the holding periods of assets to take full advantage of the long-term capital-gain rates available for assets held more than one year. As discussed earlier, taxpayers should perform hypothetical calculations prior to making a sale to avoid unexpected tax consequences.

Planning tip # 1: If you believe that capital-gain rates will be higher when you would otherwise sell an asset, make a complete analysis of your potential savings and costs before selling the asset and repurchasing it or a similar asset to refresh your basis. Often, incurring multiple transaction costs and losing the use of funds that go to pay taxes early can more than offset the savings from a lower rate.

If you anticipate being in a lower tax bracket in 2010 or expect significant amounts of capital losses in 2010, you may want to consider realizing capital gains in 2009 but deferring tax recognition until 2010. You can accomplish this by using such strategies as entering into an installment sales agreement (but not when selling marketable securities, since such gain is not deferrable)

or implementing other investment techniques. Consult your tax advisor for planning techniques specific to your situation.

Planning tip # 2: If you have short-term capital gains (which are taxed at ordinary income tax rates), consider selling capital assets that will generate a capital loss in order to offset the short-term capital gain. Taxpayers are allowed to deduct up to \$3,000 of net capital losses against ordinary income each year. Any net capital losses in excess of \$3,000 are carried over to future years.

Planning tip # 3: Under the “wash sale” rule, if securities are sold at a loss and the same — or substantially the same — securities are purchased within 30 days before or after sale of the original securities, the loss cannot be recognized until the replacement securities are sold. These rules apply even if the securities were purchased in the seller’s IRA as well as if they were purchased outright by the seller. There is, however, often a satisfactory alternative. To realize the loss and maintain the ability to benefit from the market’s upside, consider selling a stock or mutual fund to realize a loss and then replacing it in your portfolio with one having similar characteristics in the same industry or style group.

Planning tip # 4: Taxpayers interested in family wealth planning should consider gifting appreciated assets (or those that are expected to appreciate) to their children who are not subject to the kiddie tax and are in the lowest two tax brackets. Since taxpayers in the highest four tax brackets are taxed at a 15-percent long-term capital-gain rate versus a zero-percent rate for taxpayers in the lowest two tax brackets, you may realize an immediate 15-percent tax savings. If the recipient child remains in the lowest two tax brackets and the assets are sold during 2008-2010, no capital-gain tax will be due. Combining utilization of the gift tax annual exclusion with a gift of appreciating assets can be a powerful wealth transfer planning tool. This technique is discussed in further detail below. Keep in mind that, beginning with the 2008 calendar-year returns, the applicable age for applying the kiddie tax changes to include children under age 19 or full-time students under age 24.

Income tax

Planning tip # 5: If you are considering selling a business, you may attempt to structure the transaction as a sale of the company's stock rather than a sale of the company's assets. In most circumstances, a sale of the company's stock will constitute a sale of a capital asset, eligible for the lower capital-gain rate, as opposed to a sale of the assets, which may be subject to tax as ordinary income. The buyer will typically want to structure the transaction as a sale of assets in order to take advantage of certain depreciation rules; therefore, some negotiation is to be expected.

Planning tip # 6: If you expect to be in a higher tax bracket in future years or you expect tax rates to increase significantly in your retirement years, it may be more advantageous to invest in equities outside of your retirement accounts as you approach retirement. By doing so, you can obtain the favorable capital-gain rate when you sell the investment. You also may consider investing in taxable bonds in your retirement accounts, where the ordinary income generated can be deferred. Retirement plan distributions are generally taxed at ordinary income tax rates, which, today, can be as high as 35 percent and are expected to be higher hereafter. You should run a multi-year tax projection to determine the best method of investing for retirement, while keeping taxes to a minimum.

Stock option planning. Traditionally, a favorite form of performance compensation for corporate executives has been the granting of stock options. Stock options have provided executives with the flexibility to determine when they want to exercise the options and, therefore, control the timing of the tax event. Section 409A dramatically changes the tax rules applicable to options other than those used to purchase employer stock with an exercise price equal to the fair market value of the stock on the date of grant. If you now hold or subsequently receive as compensation options on property other than employer common stock (or analogous partnership equity interests in the case of a partnership employer) with an exercise price less than the fair market value of the property on the date it is granted, discuss the impact of the new rules on this compensation with your tax advisor. If any such options have been exercised, determine whether penalty taxes apply or if a position to avoid the taxes can be taken.

There are two types of stock options: nonstatutory options (also known as nonqualified stock options, or NQSOs) and statutory options (also known as incentive stock options or employee stock purchase plan options). Generally, NQSOs generate compensation income when exercised, provided that the stock is not restricted. At exercise, the taxpayer pays tax at ordinary income tax rates on the spread between the fair market value of the property received and the exercise price. Historically, taxpayers waited until near the end of the exercise period to delay the tax consequences as long as possible.

ISOs have a different tax consequence. An ISO cannot be granted with an exercise period longer than 10 years, but it can be shorter if the company so chooses. The exercise of an ISO does not affect a taxpayer's regular taxable income; however, the exercise may affect the taxpayer's AMT. Therefore, taxpayers should plan for and control the timing and exercise of ISOs.

Planning tip # 1: Consider exercising ISOs and holding the stock for the required holding period to lock in post-exercise appreciation at long-term capital-gain rates. A taxpayer is eligible to use the lower capital-gain rates if ISO stock is held for two years after the option was granted and more than one year after the option is exercised. The lower capital-gain rate makes exercising ISOs more attractive. In some cases, exercising ISOs could trigger AMT, but with careful planning, you may avoid the AMT. An eligible person who, in order to comply with federal conflict-of-interest requirements, sells shares of stock after October 22, 2004, that were acquired pursuant to the exercise of an ISO will be treated as satisfying the statutory holding-period requirements for capital-gain treatment, regardless of how long the stock was actually held.

Planning tip # 2: Many taxpayers continue to hold ISOs at retirement or termination of employment. As a general rule, retirees have only 90 days after separating from service to exercise the options as ISOs. If you are approaching retirement or planning to change jobs, determine whether it is beneficial to exercise any remaining ISOs.

Passive gains and losses. Net losses from passive activities currently cannot be deducted against income from other sources. Instead, these losses are suspended, to be deducted when the activity that generated the loss is disposed of in a taxable transaction or when the taxpayer's passive activities begin generating taxable income. Credits arising from passive activities are subject to similar rules. In addition, donations (either to family members or charity) do not permit the use of suspended passive losses or credits.

The tax law treats two types of activities as passive activities. The first is any business activity in which the investor does not materially participate. The second is most rental activities, regardless of the investor's level of participation (subject to special rules for real estate professionals).

Individuals who own rental properties and are actively involved in management decisions pertaining to such property are able to deduct up to \$25,000 of losses per year against other income. The deduction is phased out for AGI between \$100,000 and \$150,000.

Planning tip # 1: Increase your participation in what would otherwise be treated as a "passive activity" or dispose of passive activities with suspended losses or credits. This approach could allow you to use passive-activity losses or credits currently that otherwise would be deferred. Alternatively, ask your tax advisor whether decreasing your participation in a profitable business activity will make the income passive so that it can be sheltered by losses from other passive activities.

Planning tip # 2: Passive losses that are "freed up" (generally, through disposition of the activity to an unrelated party) may be used to offset ordinary income. Any applicable capital gains generated by the disposition may be eligible for the lower 15-percent rate and will be treated as passive income to allow utilization of suspended passive losses from other activities. Timing of the disposition of a passive activity should be carefully coordinated with other activities throughout the year in order to provide the best overall results.

Planning tip # 3: Remember that, generally, a disposition must be part of a taxable transaction to "free up" any suspended losses. If the activity that generated the passive losses is disposed of in a transaction other than a taxable sale, the suspended losses may be lost to the original holder. For example, if the activity is transferred by gift, suspended passive losses are added to the donee's (recipient's) basis and are not deductible by the donor. If the activity is transferred by divorce, the suspended passive losses are added to the basis of the spouse who receives the property, and the spouse who gives up the property loses the suspended losses. If the activity is transferred by sale to a related party, the suspended losses remain as suspended losses to the seller; when the related party sells the property to an unrelated party in a taxable transaction, the original seller may be able to deduct any remaining suspended losses. If a decedent holds a suspended passive loss upon death, the passive loss is reduced to the extent of any stepped-up basis, and the remainder is deductible on the decedent's final return. Passive-activity planning is a complicated area of the tax law — one that you should discuss with your tax advisor.

Planning tip # 4: Each passive activity may also have a suspended AMT loss. Suspended AMT losses are generally smaller than their regular tax counterparts because each passive activity's AMT preferences and adjustments are added back. The difference between the regular tax and AMT-suspended passive loss is recognized as a separate AMT adjustment in the year of disposition. If the difference is significant, any regular tax benefit may be lost due to a higher AMT. Further compounding the problem is that the AMT basis of the disposed passive activity will be greater than the regular tax basis in an amount roughly equal to the difference between the suspended losses under the regular tax and AMT. The result is reduced AMT capital gain (thus decreasing the applicability of preferential capital-gain rates), or worse, creation of an AMT capital loss, which will be deductible only up to the capital loss limitation of \$3,000. Obviously, the treatment of capital gains and losses is a very complicated area, and you are strongly encouraged to discuss planned asset disposition issues with your tax advisor.

Income tax

Alternative minimum tax

The individual AMT system was originally designed in 1969 to prevent the very wealthy from using a variety of special tax incentives to avoid paying income tax. The AMT, however, has evolved into an unwieldy system that will ensnare millions of unsuspecting taxpayers in coming years. Those living in states with high income taxes (such as California, New York, Montana, Oregon, and Vermont) or high property taxes (such as New York, Illinois, and New Jersey) and who have deductible personal exemptions are more likely to be affected.

Planning for AMT has become increasingly difficult. Taxpayers must be especially mindful of year-end cash payments, such as fourth-quarter state income taxes, pre-payment of investment and tax advisor fees, and charitable contributions. Current-year planning around timing of the payment of expenses that constitute itemized deductions not deductible under the AMT system is certainly important, but it may not be enough. In addition, projecting taxes from hedge funds and managing private activity bonds are among activities that take on special significance. More than ever, meaningful AMT planning requires examining multiple-year scenarios.

AMT rates, exemptions, and credits. The AMT exemption for 2008 was \$69,950 for married couples filing jointly and \$46,200 for single filers. The American Recovery and Reinvestment Act of 2009 extended AMT relief for nonrefundable personal credits and increased the AMT exemption amount for 2009 to \$70,950 for joint filers and \$46,700 for individuals. As with regular income tax, the exemption phases out for those with higher incomes. Similarly, the ability to apply most nonrefundable personal credits (including the dependent care credit, the credit for the elderly and disabled, the credit for interest on certain home mortgages, and the Hope Education Credit) against the AMT also was extended for one year by the Act.

AMT refundable credit. Beginning with calendar year 2007, some taxpayers can benefit from a refundable tax credit based on certain long-term accumulated AMT credits. The new credit may be particularly beneficial to those who exercised ISOs for which the stock value later dropped precipitously. The refundable credit amount is determined based on long-term unused minimum tax credits generated before the third tax year immediately preceding the current year. The amount of credit allowed for the current year cannot exceed the greater of \$5,000, 50 percent of the long-term unused minimum credit for the tax year, or the amount, if any, of the AMT refundable credit determined for the taxpayer's preceding taxable year as determined before any reduction. Beginning with calendar year 2008, the credit is no longer phased out for high-income taxpayers.



Planning tip # 1: Perform an AMT self-diagnosis.

Falling victim to AMT has many possible causes, but you may be particularly prone to AMT if you have any of the following circumstances:

- Large state and local income or sales tax or property tax deductions.
- Large long-term capital gains or qualified dividends.
- Large deductions for accelerated depreciation.
- Large miscellaneous itemized deductions.
- Mineral investments generating percentage depletion and intangible drilling costs.
- Research and development expenses in activities in which you do not materially participate.
- An exercise of incentive stock options.
- Large amounts of tax-exempt income that is not exempt for state tax purposes.
- A large number of dependents.
- Tax-exempt income from private activity bonds.

If you are affected by one or more of these circumstances, you should discuss your AMT situation with your tax advisor.

Planning tip # 2: If you expect to be subject to AMT in 2009 and in a regular bracket next year, consider accelerating ordinary and short-term capital-gain income and deferring certain 2009 deductions to 2010 (especially any deductions not deductible for AMT, such as state and local income taxes, real estate taxes, and investment advisory expenses). This approach is contrary to typical planning techniques, but it may reduce your ultimate tax bill.

Planning tip # 3: If you are not subject to AMT in 2009 but expect to be in 2010, accelerate expenses that are not deductible for AMT into 2009. Consider paying off home equity debt since the interest expense is often not deductible for AMT purposes.

Planning tip # 4: Some of the differences between the AMT and regular tax systems are merely matters of timing. For instance, AMT generally requires slower depreciation than is permitted for regular tax purposes. Other differences are permanent; for example, state income or sales taxes can never be deducted under the AMT system, while under the regular system they are deductible when paid. Paying AMT in one year may generate a credit against a future year's regular tax when adjustments are due to timing differences. Overall, you may be better off paying AMT currently in order to gain a credit in a later year. Perform a multi-year analysis to anticipate the effect in future years of planning techniques used in 2009.

Planning tip # 5: Consider whether any stock obtained by exercising ISOs should be disqualified before the end of the year to minimize AMT liability if the stock has dropped in value. A disqualifying disposition will limit compensation income to the difference between the exercise price and the lower value of the stock at sale. If there is a wash sale (i.e., you repurchase the same stock within 30 days of the disqualifying disposition), compensation will be computed on the spread at exercise (at the old, higher value).

Planning tip # 6: Watch out for other AMT traps. Income from private activity (municipal) bonds is taxable for AMT purposes. Certain mortgage interest, such as from a home equity loan, is not deductible for AMT purposes as home mortgage interest if the funds from the loan are not used to buy, build, or substantially improve a primary or second home. Be sure to tell your tax advisor if you used the borrowed funds in your business or to make investments, as the home equity loan interest may be deductible except certain bonds issued in 2009 and 2010.

Income tax

Charitable contributions

Donated clothing and household goods must be in good condition, with discretionary power given to the IRS to disallow the deduction based on condition. Household items include furniture, furnishings, electronics, appliances, linens, and other similar items. Food, paintings, antiques, objects of art, jewelry and gems, and collections are excluded from the provision and are subject to different rules.

Increased reporting requirements are also in effect. For a monetary gift of any amount, either a written record (such as a credit card statement or cancelled check) or a written contemporaneous acknowledgement from the charity is required. When property other than cash, inventory, and publicly traded securities is donated to charity, and such property is valued above \$5,000, the property must be appraised in order to claim a charitable deduction. If the value exceeds \$500,000, the appraisal must be attached to the donor's income tax return, whether the donor is an individual, partnership, or corporation.

With respect to contributions of intangibles, if a donor contributes a patent or other intellectual property (other than certain copyrights or inventory) to a charity, the donor's initial charitable deduction is limited to the lesser of basis or fair market value. If the donated property provides income to the charity, the donor may deduct certain additional amounts in the year of contribution or subsequent years, based on a specified percentage of the income received by the charity.

Planning tip # 1: If you are planning to make a gift to a charity in 2010, consider making the gift in 2009 to accelerate the tax benefit of the contribution. Gifts to qualified charities qualify for an unlimited deduction for gift tax purposes; therefore, the \$13,000 limit that applies to gifts to others does not apply to gifts to charities. In other words, outright gifts in any amount can be made to a qualified charity without paying gift tax. Gifts in trust for charity and gifts of partial interests in property, however, may be subject to gift tax. It is also important to note that certain limitations exist with respect to the aggregate amount of income tax deductions for charitable contributions.

Planning tip # 2: Taxpayers planning to make a contribution to a public charity should consider a gift of appreciated securities. By making such a contribution, you may be able to deduct the full market value of the gift for both regular and AMT purposes (if the securities were held for more than one year), whereas if the securities are sold and the proceeds donated, both you and the charity will receive a lesser benefit.

For example, if you contribute an appreciated security that has a basis of \$20,000 and a fair market value of \$100,000, you may take a deduction equal to \$100,000 (subject to certain limitations) and the charity receives a gift worth \$100,000. If you sold the securities and donated the proceeds (less capital-gain tax), the charity may receive only \$88,000 [$\$100,000 - ((\$100,000 - \$20,000) \times 15 \text{ percent})$]. In addition, you could receive a lesser tax benefit.

Planning tip # 3: In addition to receiving a greater tax benefit from donating appreciated securities (rather than cash) to charity, you can use the cash that would have been donated to charity to purchase new investments and "refresh" your basis. For example, assume a taxpayer would like to provide a public charity with a \$100 benefit, and the taxpayer is indifferent as to whether the donation is made in cash or other assets.

	Gift of stock	Gift of proceeds (net of capital-gain tax)
Charitable gift	\$100,000	\$88,000
Marginal tax rate	35%	35%
Net tax	None	\$12,000
Benefit of gift	\$35,000	\$30,800

The taxpayer has XYZ stock in his or her portfolio, with a cost basis of \$10 and a fair market value of \$100. If the taxpayer donates the stock to the charity, he or she will get a charitable deduction of \$100, subject to certain limitations. The taxpayer can then use the \$100 that he or she otherwise would have donated to charity to repurchase XYZ stock. The basis of the taxpayer's new XYZ stock is \$100. In effect, the taxpayer received a step-up in basis of the XYZ stock from \$10 to \$100 in addition to meeting his or her charitable goals. Remember that the wash sale rules apply only to losses upon sale, not gains; therefore, the wash sale rules do not apply to this situation.

Planning tip # 4: Each single donation of \$250 or more requires a contemporaneous, written description of the contribution from the charity in order to qualify for the charitable contribution deduction. A cancelled check is not sufficient to support the deduction. These rules apply even if the donation is made to your own family foundation. Also, any gift in excess of \$5,000, other than cash or stock in a publicly traded company, requires an appraisal from a qualified appraiser in order to qualify for the deduction.

If you donate a used vehicle, boat, or airplane worth more than \$500, the deduction will equal the fair market value of the contribution only if the charity uses the property in its tax-exempt function. If the charity sells the item, your deduction will generally be limited to the proceeds the charity actually receives. The charity will be required to furnish donors with a receipt that documents sales proceeds.

When making a noncash donation, consider the following requirements:

Documentation of charitable deductions

\$0 to \$249	Maintain a bank record or a receipt, letter, or other written communication from the \$0 to \$249 donee, indicating the donee's name, the contribution date, and the amount.
\$250 to \$500	Obtain a written acknowledgment from the charitable organization.
\$501 to \$5,000	In addition to a written acknowledgment, show the means of acquisition, the date acquired, and the adjusted basis of the property.
More than \$5,000	Obtain a written appraisal (publicly traded securities do not require written appraisals).
More than \$500,000	Attach a written appraisal to the tax return if appraisal is required.

Planning tip # 5: Consider contributing to a donor-advised fund (DAF) — a fund that is managed under the tax umbrella of a public charity such as a community foundation. The donor makes an irrevocable gift of property (such as stock) to the host charity and receives a tax deduction equal to the fair market value of the property in the year of the gift. Assets are deposited into an investment account where they can grow tax free. The donor retains the right to advise (but not to direct) the host charity in administering the affairs of the DAF. Only one receipt (for the donation to the fund) is required instead of one receipt from each charity, which can significantly simplify tax-time recordkeeping.

Depending on the policies of the host charity, advice may include naming the fund, managing investments, recommending grants, and selecting a replacement advisor at the death of the donor. DAFs cannot benefit the donor or any other private interest.

Income tax

Retirement planning

Successful retirement planning begins long before retirement. In fact, most of us should be accumulating capital throughout our working careers to sustain us in later years. Sound retirement planning involves reviewing your entire financial profile. While taxes obviously are not the only issue, they are central to retirement planning. The tax-related decisions you make today, and at various points in your career, may have a marked effect on how you save for retirement and how much you will have down the road to support your goals. Many tax decisions you make about retirement are one-time choices that can be very costly to change, so it pays to plan.

Planning tip # 1: Sole proprietors or partnerships may establish a Keogh plan for themselves and their employees. Although contributions do not have to be made until the due date of the tax return (including extensions), the plan must be established by the end of the year. For 2009, self-employed individuals may contribute the lesser of \$49,000 or 100 percent of self-employment income to a defined contribution Keogh plan; however, any nondeductible amount (generally, any amount above the lesser of \$49,000 or, in the case of plans for self-employed individuals with no employees, 20 percent of net self-employment income) is subject to a 10-percent excise tax. Self-employed individuals, therefore, generally contribute only the lesser of \$49,000 or 20 percent of their net self-employment income. For purposes of



the 20-percent limitation, net self-employment income includes a deduction for contributions to the plan. Older individuals should consider establishing a defined benefit Keogh plan, which will likely allow a higher contribution amount.

Planning tip # 2: If you are an owner/employee of an S corporation without other employees, you may consider establishing a defined-benefit plan. Generally, an owner/employee will be able to contribute more to a defined-benefit plan than a defined-contribution plan. In addition, you may make contributions to the defined-benefit plan in a year in which you do not receive any compensation (or earned income if you are considered self-employed). In contrast, contributions to a defined-contribution plan are limited to the lesser of \$49,000 or 100 percent of compensation (or earned income for persons considered self-employed); therefore, if you earn no compensation in a particular year, you may not make a contribution to a defined-contribution plan for that year.

Planning tip # 3: In addition to contributing to Keogh plans, self-employed individuals are eligible to establish solo 401(k) plans and SEP Individual Retirement Accounts (IRAs). Solo 401(k) plans must be established prior to year-end, whereas a SEP IRA may be established and funded at the time of filing the individual income tax return (including extensions). Each plan has its advantages and disadvantages; therefore, if you are self employed, you should discuss retirement plan options with your financial advisor to determine which plan works best for you.

Planning tip # 4: Earning compensation for serving on a company's board of directors may qualify as self-employment income and, therefore, be subject to self-employment taxes. If you earn self-employment income, you may qualify to sponsor a Keogh or other self-employed retirement plan. Qualification as self-employment income may be possible even if you are an employee of the company, as long as the self-employment earnings are sufficiently segregated from wage income. The rules in this area are complex; if you earn director fees, discuss this topic with your financial advisor.

Planning tip # 5: Analyze contributions to employer-sponsored 401(k) plans. The maximum contribution to a 401(k) plan is \$16,500 for 2009. Many investors have considered stopping contributions to their 401(k) plans in favor of investing in currently taxable accounts due to the lower capital-gain and dividend rates. But, you should recall that amounts contributed to a 401(k) plan are pre-tax, which means they may lower your current tax bill and affect AMT planning. Also, if your employer offers matching contributions, you could be giving up "free" money. Talk to your investment advisor to determine whether it is better to invest funds in a currently taxable account or a tax-deferred account.

Planning tip # 6: Consider making contributions to a Roth IRA. Although contributions to a Roth IRA are never deductible, any income earned within the Roth IRA may be free from federal income tax when you withdraw money from the account. The maximum annual contribution to a Roth IRA is \$5,000 for 2009. The maximum permitted annual contribution begins to be phased out when AGI reaches \$166,000 for joint filers and \$105,000 for single filers. Unlike traditional IRAs, Roth IRAs permit contributions after reaching age 70-1/2.

Income tax

Planning tip # 7: If you are age 50 or older by year-end, you may make additional catch-up contributions to your retirement plans, including an additional contribution of \$5,500 to your 401(k) plan in 2009. Check with your plan administrator for the proper procedure to make catch-up contributions to your 401(k) plan. For an IRA or Roth IRA, you may make additional contributions of \$1,000 for 2009. Participants in SIMPLE plans may make additional contributions of \$2,500 in 2009.

Planning tip # 8: Consider establishing a spousal IRA. A spouse who has little or no earned income and who is not an active participant in an employer-sponsored retirement plan can still have an individual retirement account. The maximum contribution to a spousal IRA is the lesser of \$5,000 or the combined taxable compensation of both spouses. The deduction for such contribution begins to be phased out for married taxpayers filing jointly with 2009 AGI of \$166,000. Although the contribution may not be deductible, the amounts contributed will still grow tax deferred; therefore, this may still be a good retirement planning option.

Planning tip # 9: Make IRA contributions prior to the end of the year, even though the contributions are not due until April 15. Making contributions earlier increases the effect of compounding on retirement account earnings. As with the spousal IRA, even if the contribution is not deductible, it will grow tax deferred. If your contribution is deductible, your AGI will be lower, possibly allowing you to take advantage of certain credits that are limited by AGI levels; take this into consideration when making year-end decisions. Taxpayers are allowed to contribute to both a 401(k) plan and an IRA in the same year; however, if you contribute to a 401(k) plan (or any other employer-sponsored retirement plan), your ability to deduct contributions to an IRA in the same year will be limited if your 2009 AGI exceeds \$89,000 for joint filers.

Planning tip # 10: An excise tax is imposed on excess contributions to various savings vehicles. Generally, excess contributions to an IRA, medical savings account, health savings account, or Coverdell account (also known as an Education IRA) are subject to a six-percent excise tax. Excess contributions to other qualified plans (e.g., 401(k) plans) are subject to a 10-percent excise tax. In addition, contributions to Keogh and pension plans in excess of the deductible amount are subject to a 10-percent excise tax. To avoid potential excise taxes, correct excess contributions before year-end.

Roth IRA conversions. For those that qualify, as discussed further, it may be advantageous to convert an IRA to a Roth IRA. Although the amount rolled over or transferred from a traditional IRA to a Roth IRA generally must be included in gross income, qualified distributions from a Roth IRA are tax free, including the income and appreciation components of such distributions. In order for a distribution to be a qualified distribution, a five-year holding period must be satisfied, and one of the following four requirements must be met:

- 1 The distribution is made on or after the date on which the individual attains age 59-1/2.
- 2 The distribution is made to a beneficiary or the individual's estate after the individual's death.
- 3 The distribution is attributable to the individual's being disabled.
- 4 The distribution is to pay for certain qualified first-time homebuyer expenses (up to \$10,000).

Each conversion amount has its own holding period and will avoid the 10-percent early withdrawal penalty if it remains in the Roth IRA for five years.

There are several other advantages to Roth IRAs. Contributions are permitted after the individual reaches age 70-1/2 and the mandatory distribution rules applicable to traditional IRAs during the lifetime of the owner do not apply. There are also income tax benefits to heirs who inherit a Roth IRA. Unlike distributions from a traditional deductible IRA, the distributions are not subject to income tax. (Distributions from a nondeductible IRA will be partially taxable, as the heirs benefit from the decedent's basis in the IRA.)

For 2009, only individuals with modified AGI below \$100,000 may convert a traditional IRA to a Roth IRA. In 2009, in addition to any traditional IRA (including a SEP IRA), if you receive a distribution from an employer plan that is eligible for rollover treatment and you qualify for a Roth IRA conversion, you can roll the money directly from the employer plan to the Roth IRA. Beginning in 2010, all taxpayers have the opportunity to convert traditional IRAs into Roth IRAs without limitations based on their income level. If you currently have IRA accounts, you and your tax advisor should discuss the possibility of converting to a Roth IRA. While income taxes would be due currently, you and your heirs may have more after-tax wealth as a result of the conversion.

Planning tip: Plan for an IRA to Roth IRA conversion in 2009, if applicable. If you are not eligible to contribute to a Roth IRA due to the income threshold, you should consider contributing to a regular nondeductible IRA so those amounts can eventually be converted to a Roth IRA in 2010. Contributions to a nondeductible IRA build basis in the plan, which will be nontaxable at the subsequent conversion in 2010. Consult your tax advisor if you have other IRAs.

Roth 401(k) contribution program. Beginning in 2006, employees who elect to contribute to a 401(k) plan may designate some or all of these contributions as Roth IRA contributions (designated Roth contributions) if their particular 401(k) plan permits such treatment. Designated Roth contributions are included in taxable income in the contribution year; however, distributions from the designated Roth portion of the 401(k) plan after the employee reaches age 59-1/2 will be tax free. Designated Roth contributions must be accounted for separately within the 401(k) plan. The maximum amount an employee may contribute to all 401(k) plans, including designated Roth contributions, is \$16,500 in 2009. In addition to these amounts, taxpayers over age 50 by the end of the year can make additional contributions of \$5,500, for a total maximum contribution of \$22,000.

Nonspousal inherited retirement assets. Beginning in 2007, an individual receiving an inherited qualified retirement plan from a decedent other than a spouse may roll over the inherited account into his or her own IRA. The rollover must be executed by a trustee-to-trustee transfer and must be done by December 31 of the year following the year of death. The inherited amounts transferred to the IRA will be treated as an inherited IRA subject to the IRA minimum distribution rules; thus, beneficiaries will be able to continue the minimum distribution schedule that would have applied had the decedent not passed away.

Distributions from tax-preferred retirement savings. In general, a 10-percent early withdrawal penalty applies to distributions from qualified plans and IRAs for participants who have not yet reached age 59-1/2. There are numerous exceptions to this general rule; therefore, if you need to withdraw funds prior to age 59-1/2, you should consult with your financial advisor.

Income tax

Generally, taxpayers who have reached age 70-1/2 by December 31 must start receiving required minimum distributions from qualified plans or be subject to severe penalties. Generally, minimum distributions must begin for the calendar year in which the taxpayer reaches age 70-1/2 (or when the taxpayer retires, if later) and must be paid no later than April 1 of the following year. For every year thereafter, distributions must be made by the end of the year. If the first distribution is delayed until the year following the year in which the individual reaches age 70-1/2, then two distributions will be required in that year (one by April 1 and one by December 31). For subsequent years, only one distribution will be required by the end of the year. The rules differ between self-employed individuals and non-self-employed individuals, so check with your financial advisor to determine whether you are subject to special rules.

Because of the general economic downturn, provisions in the Worker, Retiree, and Employer Recovery Act of 2008 suspended the general rules for required minimum distributions for 2009 and suspended the need to make certain elections that would otherwise be due in 2009 (e.g., whether a person age 70-1/2 in 2009 decides to take a current distribution or take two distributions in 2010, the act pushes the required payment dates out one additional year). Consequently, depending upon the terms of your plan, normally required distributions may be waived, or if received, can be rolled into an IRA; or if required distributions were taken from an IRA, they may be rolled back into an IRA. The rollover relief provisions are time sensitive. Consequently, if you are required to make certain retirement plan elections in 2009 or have received required minimum distributions during 2009, check with your financial advisor to determine whether you should consider deferring the 2009 required minimum distribution payments further.

Planning tip # 1: In general, a penalty is imposed on withdrawals from a qualified plan or IRA prior to age 59-1/2. Ideally, you will not need funds prior to retirement; however, where funds are withdrawn from a qualified plan or IRA prior to age 59-1/2, the withdrawal may take place without penalty if the participant died or suffered a qualified disability. In addition, funds may be withdrawn without penalty under the following circumstances: (1) the payments are made following separation from service after attaining age 55 (not applicable to IRAs), (2) the payments are made in a series of substantially equal payments over the life of the participant (or joint lives of the participant and beneficiary), (3) distributions are used to pay qualified medical expenses that exceed 7.5 percent of AGI, (4) distributions are made to a nonparticipant under a qualified domestic relations order, or (5) for certain distributions of dividends on employer securities made by employee stock option plans (ESOPs).

Separate exceptions apply to distributions from other tax-deferred plans (such as SEP IRAs, SIMPLE plans, Keoghs, and 401(k) plans), as well as IRAs and Roth IRAs; therefore, you should discuss your options with a qualified financial advisor.

Planning tip # 2: Although the first required minimum distribution does not need to be paid until April 1 of the year following the year the taxpayer reaches age 70-1/2, postponement of the initial payment will result in doubling up on payments in the following year. For example, you reach age 70-1/2 in 2009, the first required minimum distribution does not need to be paid out until April 1, 2010; however, the required minimum distribution for 2009 also must be received by December 31, 2010, resulting in two payments in 2010. This will increase your AGI and may push you into a higher tax bracket in 2010 and affect other tax planning strategies.

Planning tip # 3: The required minimum distribution rules do not apply to Roth IRAs during the lifetime of the owner. Distributions from Roth IRAs are required after the death of the participant if the spouse is not the beneficiary. When the spouse is the beneficiary of a Roth IRA, the Roth IRA may be treated as owned by the surviving spouse after the death of the first spouse.

Planning tip # 4: In certain situations, an individual may receive a distribution of employer securities out of a qualified retirement plan while deferring taxation on unrealized gain until the securities are subsequently sold. At that point, realized long-term capital gains will be eligible for the lower rates and can be offset by capital losses from other investments. Check with your financial advisor if you currently own employer securities inside of a qualified plan and anticipate a distribution, in order to create a favorable tax outcome.

An excess accumulation is any amount of a required minimum distribution that is not distributed in a timely manner. A hefty 50-percent excise tax is imposed for each year the excess is not distributed. Although penalties may be waived under certain circumstances, taxpayers should make every effort to comply with the required minimum distribution rules.

State income tax planning

Most tax planning focuses on saving federal taxes; however, state tax planning, especially for individuals living, working, or holding property in states with high tax rates, is equally important. Some individuals work and earn income in more than one state, requiring an analysis of the tax laws of several states as well as the possibility of having to file several different state income tax returns. State laws vary widely, and the interaction between laws can be complicated. This guide cannot possibly cover all aspects of state tax planning; therefore, we encourage you to consult with your local tax advisor for more detailed state tax planning techniques.

Planning tip # 1: Many states offer special business incentives to those who work in or operate a business in that state. For example, multiple states offer an enterprise zone credit that may offset sales tax or provide significant hiring credits.

Planning tip # 2: Certain states may allow a discount for early payment of taxes. For example, some Florida counties provide a discount of up to four percent for early payment of property taxes. It is important to consider these discounts in conjunction with AMT planning.

Planning tip # 3: Taxpayers (including trusts) who have a sufficient nexus with more than one state may owe taxes and have reporting requirements in multiple states. Nexus may be created through a variety of contacts; however, the most common are working in another state, owning property in another state, or engaging in a business activity in another state. Trusts may have nexus due to the residency of the beneficiary, the trustee, or the person who funded the trust (even if he or she died many years earlier). To complicate matters, each state may have its own definition of nexus, residence, and domicile. Credits may be available in your resident state to offset taxes paid to other states; therefore, you are strongly encouraged to check with your local tax advisor to determine where taxes may be due, what credits may be available, and whether you must file a return in more than one state.

In addition to a separate income tax, many states have their own gift, estate, and inheritance taxes. In other words, you may be liable for not only federal taxes in these areas, but also state taxes. Individuals living in states that have an estate tax may end up paying more in overall estate taxes than would have been the case prior to the federal estate tax reforms of 2001, even as the federal estate tax rate drops. Consideration of state taxes must be part of any taxpayer's overall financial planning, especially individuals who are considering moving to another state upon retirement. Although the taxpayer may save income taxes by the move, total taxes in the new locale may create an unexpected tax burden.

Investments



In the wake of the recent market troubles, the media is full of articles proposing new approaches to investment management. Just as in prior market downturns, both self-proclaimed pundits and everyday investors question whether radically different approaches are called for:

- Should asset allocation, often considered the “best practice” approach to investment management, be scrapped as having been proven ineffective to prevent losses in the stock market?
- Have all of the lessons taught by the history of the markets become irrelevant?
- Has the world economy been fundamentally damaged such that our remaining years will be filled with economic gloom?

We believe that the answer to each of these questions is “no.” While investors should avoid overreacting in response to a market crisis, it is natural and healthy for us to re-examine our fundamental investment plans and take advantage of lessons learned from the worst market performance since the 1930s.

Investing money is a complex business fraught with many risks — market and otherwise. How do you put together an investment portfolio that fits your needs and addresses risk in an appropriate way? It is easy to lose your perspective in an environment of bad economic news and declining stock markets. It is equally easy to lose your perspective when the economic news is good and stock markets are soaring. By considering your current investment plan within the context of six steps, you may discover opportunities to improve your current investment structure while maintaining the sense of order that comes with sticking to key investment planning fundamentals.

Understand your current needs, goals, and preferences

Navigating investment markets is not easy. A well-thought-out, clearly articulated, and documented investment plan is essential. While it is sometimes tempting to shortchange this up-front work, an investment plan can have a strong bearing on performance. As with many facets of wealth planning, an investment plan is only as good as its foundation. Understanding your needs, goals, and preferences is the key first step to the development of an appropriate investment plan. Updating your investment plan periodically as your needs, goals, and preferences change is equally important.

- **Quantify your lifestyle needs and other specific financial objectives.** This will help you understand what demands will be required from your portfolio and help you determine what level of risk is appropriate in your portfolio.
- **Understand what resources you need to maintain your financial independence.** Oftentimes, you are making portfolio decisions that impact your heirs and beneficiaries more than they impact you. It is important to understand your own financial independence requirements. Doing so can help you pursue appropriate wealth transfer strategies during your lifetime with your investment portfolio assets.
- **Determine whether resources should be managed pursuant to a single investment plan or two or more separate investment plans.** It may be appropriate to develop a separate investment plan specifically for assets previously allocated to wealth transfer planning strategies.
- **Understand your tax environment.** What is your marginal tax bracket? Do you expect to be subject to the alternative minimum tax? Do you hold assets in a taxable trust? Do you have tax-deferred or tax-exempt accounts such as IRAs, Roth IRAs, deferred compensation plans, or Section 529 educational savings plans?

Use asset allocation as the structural basis of your strategic investment plan

Those who suggest scrapping the asset allocation approach in the wake of the recent downturn need to examine their own expectations for the approach. While investors who utilized the asset allocation approach effectively dampened their losses during this crisis, it is unrealistic to assume that it will allow us to sidestep all losses, particularly those resulting from a global economic crisis.

While most people know that investment portfolios should be diversified to reduce risk, investment portfolios also should be diversified to help maximize returns. Diversification involves more than just owning many different types of assets. Asset allocation is the technique of investing in a number of asset classes (e.g., large-cap stocks, foreign stocks, intermediate-term bonds, real estate, etc.) in targeted proportions to achieve the best possible expected return for the risk assumed. A properly designed asset allocation effectively buffers your portfolio's lows and highs. Beyond providing a more comfortable ride, a properly designed asset allocation also is likely to provide the following benefits:

- Enhanced likelihood of achieving an expected return for a given level of risk through an "efficient portfolio" asset allocation.
 - Control, to the extent possible, over portfolio risk.
 - Reasonable expectations of long-term returns and downside risk — studies have indicated that something on the order of 92 percent of an investor's expected return is determined by asset allocation.
 - Rebalancing — the systematic selling of outperforming asset classes together with purchases of other classes with depressed values — which can help control portfolio risk and provide the opportunity for improved portfolio returns.
- Planning tip:** While some asset classes may be characterized by higher market value volatility, the addition of such asset classes in moderation to a portfolio actually may help reduce the volatility of the portfolio as a whole.

Investments

Considerations for asset location techniques to improve the tax efficiency of your portfolio

Tax-inefficient assets are those that regularly generate investment returns taxed at ordinary income tax rates, such as:

- Taxable bonds
- Treasury Inflation-Protected Securities (TIPS)
- Real estate investment trusts (REITs)
- Commodity futures funds
- Hedge funds
- High turnover stock funds

A portfolio's after-tax return can be improved through the appropriate location of investment assets. For example, while a traditional IRA provides significant tax benefits through tax deferral, the taxable portion of withdrawals is always taxed at ordinary income rates, even if the source of earnings in the IRA is long-term capital gains and qualified dividends. In effect, an IRA converts tax-favored long-term capital gains and qualified dividend income into unfavorable ordinary income. In addition, appreciated IRA assets do not receive a step-up in basis at death as do most appreciated assets held in your personal non-IRA portfolio.

Planning tip: Consider allocating tax inefficient assets such as taxable bonds and TIPS to tax-deferred accounts such as IRAs and 401(k)s. If you have a Roth IRA, consider using this account for your higher expected return tax-inefficient assets such as REITs and commodity futures funds. If you do not have a Roth IRA, consider allocating these assets to your traditional IRA account. Consider allocating low turnover long-term capital-gain assets and municipal bonds to taxable trust accounts and personal accounts.

Put your investment plan in writing

Creating an investment policy statement offers many potential benefits. At the outset, this process can help raise and address questions that you may have considered but not really answered, such as:

- What is your return objective?
- How much risk can you tolerate without “jumping ship”?
- Which asset classes, if any, are you unwilling to consider?
- What is an acceptable level of liquidity?
- How much focus will you place on managing taxes?

In addition, the policy statement records the strategy and rationale behind your investment plan in a document that can have a calming influence when it feels as though the investment markets are in a freefall. Among other things, it reminds you that you knew there would be difficult periods and that you committed to weathering the storm, knowing that making significant changes when the markets are in turmoil typically undermines long-term performance.

Planning tip: You should know how much you stand to lose. What is the downside risk in your current portfolio? Computer modeling can help you assess potential worst-case results. The tradeoff between risk and return is at the root of all investment planning; therefore, it is critical that you remain actively involved in deciding how much risk you are willing to accept. Understanding up front the potential downside of your portfolio can help you overcome reactionary urges in volatile markets.

Implement your investment plan

Indexing or active management. A stock market index is simply a method to measure a portion of the stock market, and an index fund is an investment approach designed to track a particular index. Indexing may appear simpler than using active managers who try to pick stocks that will provide superior results. Index funds generally hold most or all of the stocks represented in the index, even those that have poor risk/return characteristics. In an actively managed fund, a manager makes judgements on whether a security's risk/reward characteristics merit inclusion in the portfolio.

Bull markets reward risk-taking of all types, and indexing generally benefits. When a market pulls back, however, the relative gains of indexing have, in many recent cases, been erased and investors may again see the long-term benefits of combining both active management and more selective stock ownership.

Many studies have concluded that indexing is appropriate as fewer than 25 percent of active managers outperform the index, and those that do outperform have difficulty repeating the feat. Deloitte's research shows that outperforming an index is also very dependent on asset class and the quality and availability of information. For example, there is a lot of information available on large domestic companies, and many individuals follow these companies. This may make it difficult to outperform the S&P 500 index — the large-cap market index. On the other hand, small companies are less followed and more difficult to gather reliable information on, making the due diligence conducted by professional managers of small-cap portfolios more valuable. As a consequence, small-cap managers historically have a better record of outperforming their respective index.

Planning tip: Within equities, it is also important to diversify your holdings among those with growth styles (managers who look for companies they believe are likely to have above-average growth, even if their share price seems expensive) and those with value styles (managers who focus on stocks they believe are underpriced based on an evaluation of their book value and other factors — the antithesis of the growth style-managers). After seven years of strong performance by value stocks, growth stocks have begun to stage a comeback. Maintaining a balance of growth and value exposure may help your portfolio benefit from these cycles.

Tactical planning. Most investors are best served by staying with their targeted strategic asset allocations through good times and bad. If you do want to employ some tactical planning (going slightly off the target of your strategic allocation based on your views of the likely direction of certain asset classes), consider these often-quoted words from Warren Buffett: "If [investors] insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy only when others are fearful."

Controlling costs. A down market provides a clear reminder that none of us controls the performance of our portfolios. You can, however, exercise control over the one certainty of your investment portfolio — its costs. Costs often can be negotiated, particularly when you have the leverage that comes with volume. Through negotiation, you may be able to reduce both investment manager fees and transaction costs.

Planning tip: Mutual funds offer some opportunity for savings as certain share classes have reduced costs. Separate account managers, however, generally afford affluent investors the opportunity for a lower cost structure.

Investments

Monitor and supervise

Once your funds are invested according to your investment policy, it is important to monitor the performance of investment managers regularly and make changes as appropriate (e.g., rebalancing or replacing managers.) But, in periods of market turmoil, many investors tend to overmonitor and, worse, begin to question the entire plan.

Stay the course during difficult times. While it is difficult to watch the value of your portfolio decline, it is important to maintain perspective. First, you still own everything you owned before. Imagine that there is an electronic sign on your home that continually shows its value. Some days, the value is up, but then your neighbor paints his house a garish color and your home's value drops. Though you own the same house, the market's perception of its value is changing. The same is true of your stock portfolio.

Despite gyrations in the economy and the value others may place on your holdings, you continue to own shares in the same companies that you did before; the economy has simply put a lower price on them for the time being. At some point normal market valuations will return, just as at some point your neighbor will repaint his home (hopefully at the insistence of the homeowner's association).

While some investors inevitably will flee to cash after a beating in the stock market, history shows that the stock market begins to recover somewhere between four and 10 months in advance of the trough of economic activity. Indeed, we have recently seen such a rebound in market values. Fleeing the stock market when it is at a low point leaves you at risk of missing a handsome recovery.

Planning tip # 1: Continue careful recordkeeping and take time to analyze the impact of your tactical asset allocation decisions. Evaluate whether your tactical moves, on balance, have added wealth or been ineffective over time.

Planning tip # 2: While harvesting losses can make sense from a tax perspective, make sure you are not overlooking investment implications that could more than offset the tax gains. In some cases, the primary benefit of harvesting a tax loss is simply to offset the payment of capital-gain tax.

For example, a taxpayer who has recognized substantial net long-term capital gains earlier in the year also has an asset, Acme stock, with a tax basis of \$6 million that has declined in value to \$5 million. Although the investor and his or her advisor had planned to sell the stock next February, they have decided to harvest the loss on Acme before the end of the year to reduce this year's tax bill. A rough calculation of the benefit from harvesting the \$1 million capital loss on Acme is as follows:

Gain deferred	\$1,000,000
Capital-gain tax rate	15%
Tax deferred	\$150,000
Time value of money factor	4%
Annual benefit of loss harvesting	\$6,000
As a percentage of the \$5,000,000 asset value	0.12%

In other words, by harvesting the loss before year-end the taxpayer has the use of \$150,000 of funds that otherwise would have been used to pay taxes. Assuming that the taxpayer earns four percent after taxes on these funds, the benefit is \$6,000, annually.



But what happens if, rather than harvesting the loss, the stock was retained and its value increased by a mere one percent (from \$5 million to \$5.05 million) before it was sold in the following year? By holding the stock for this short time and allowing it to gain incremental value, the taxpayer would have gained \$50,000 on a pre-tax basis, or \$42,500 after taxes (assuming an effective rate of 15 percent on the long-term capital gain) — a gain more than seven times greater than the benefit attained by loss harvesting this year.

As the above example demonstrates, investors should not lose sight of the investment implications of a sale. If loss harvesting only serves to offset capital gains, a combination of low capital-gain rates and low overall interest rates can nullify the benefits. It also is important to consider the risk of higher future capital-gain rates. An old adage is particularly applicable here: you never want to let the tax tail wag the economic dog.

Fixed-income unease. Bonds are supposed to be the portion of your portfolio that provides some stability. The recent credit crunch, though, has disrupted the fixed-income markets, and the relative performance of fixed-income managers (compared to fixed-income indices) has been among the worst experienced in decades. In most cases, it makes sense to withhold judgment of fixed-income managers until these markets normalize; historically, periods of fixed-income underperformance have been followed closely by sharp reversals in relative performance. In the meantime, compare fixed-income managers primarily within peer groups.

Evaluating active management. While the stock market as a whole has had its ups and downs during 2008 and 2009, active managers who focus on quality have performed relatively well in comparison to their appropriate indices during that time period. If you are making comparisons, look at the performance of your actual portfolio against a customized composite benchmark of appropriate indices. In addition, evaluate your individual managers by comparing their performance to an appropriate benchmark as well as against other managers within their appropriate peer group.

A succession plan for your investment portfolio.

Once you have built wealth, you become responsible for seeing that it is successfully managed. Through your estate plan, you direct where the wealth goes when you die, but you also should address:

- Who will manage your portfolio if you are no longer able to do so effectively?
- Who will make investment decisions for your family after your death?
- Provide your spouse, children, grandchildren, and other beneficiaries with investment planning experience now.

Planning tip: Wealth planning vehicles that allow you to channel growth downstream to manage estate taxes also can be excellent tools for family investment education. While you may have legal control of the investment planning for a family partnership, family limited liability corporation, or similar vehicle, you can choose to have family members actively participate in investment decision-making so they are prepared when their time comes to be the actual decision-makers.

Wealth transfer tax

As was previously mentioned in *The current environment* section, while the fog of battle still obscures the exact dimensions of the federal estate tax, on one point there appears to be near universal consensus — that the tax will survive indefinitely. Furthermore, while the size of the applicable exclusion amount, the rate structure, and the interplay of the estate tax with both the gift tax and state estate taxes remains obscure, it is equally clear that the estate tax will not be inconsequential to those who fall under its ambit. Notwithstanding, the decision to transfer wealth to family members or charity should never be motivated solely by tax considerations. Once again, never let the tax tail wag the economic dog. But once the decision has been made to transfer certain assets, or a certain amount of assets, to someone else, taxes should be considered. Put another way, taxes should not drive the who, the what, or the why of wealth transfer planning, but they definitely influence the how and the when. With that as a background, the following information may be helpful in managing the government's share of your family's wealth.

Gift tax

Most transfers of property during life are subject to the gift tax system. Gift tax is computed based on the fair market value of the property transferred. Some types of transfers are excluded in determining the total amount of gifts that are subject to tax. For example, in 2009 gifts by individuals of up to \$13,000 per recipient are generally covered by the gift tax annual exclusion and are not subject to gift tax. The annual exclusion is adjusted for inflation, and it is anticipated that the annual exclusion will remain at \$13,000 per recipient in 2010. A few states also assess a gift tax.

To qualify for the annual exclusion, gifts must be of a present interest. Such an interest can include any outright gift, including transfers under the Uniform Transfer to Minors Act and funds contributed to Section 529 educational savings plans. Certain gifts in trust also qualify if the trust allows the beneficiary a choice between withdrawing the gifted property and leaving it in the trust.

In addition to the \$13,000 annual exclusion, every individual taxpayer can transfer a certain amount of property during his or her lifetime without paying gift tax. The amount of property that can pass tax free is referred to as the applicable exclusion amount. The applicable exclusion amount is used to calculate the credit available to offset the gift tax. The applicable exclusion amount for lifetime gifts is \$1 million in 2009 and 2010. The top gift tax rate is 45 percent in 2009, and it is applied to total taxable gifts over \$1.5 million. (Gifts between \$1 million and \$1.5 million are taxed at 41 percent on the low end and 43 percent on the high end.) Due to the way gift tax is calculated, if a donor has paid gift tax on any gifts in the past, such donor's applicable exclusion amount may not exempt the tax on a full \$1 million of lifetime gifts. If you have made substantial gifts in the past, talk to a tax advisor prior to making additional gifts to determine the amount of taxable gifts you can give before you become subject to a gift tax liability.

Due to significant changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (the 2001 Tax Act), the maximum gift tax rate is set to be reduced to 35 percent in 2010. Consensus is that Congress will act before the end of 2009 to fix the highest marginal gift tax rate for 2010 at its current level of 45 percent. It is important to note that the 2001 Tax Act contains a sunset provision, which will cause the rate to revert to 55 percent after December 31, 2010, unless Congress enacts different rules. If the 2001 Tax Act expires, all of the rules that were in effect during the 2001 tax year for estate, gift, and generation-skipping transfer (GST) taxes will go back into effect.

Transfers to a spouse who is a U.S. citizen are covered by the unlimited marital deduction; therefore, such transfers may be made totally free from gift tax. If your spouse is not a U.S. citizen, then the amount that can be transferred to your spouse free of gift tax is limited to \$133,000 in 2009. If either you or your spouse is not a U.S. citizen, it is imperative that you make your estate planner aware of this fact.

Planning tip # 1: An annual gifting program can shift significant wealth down generational lines. This is especially true if the asset being transferred appreciates and/or generates income that will be excluded from the donor's estate. If you are interested in a gifting program, consider a trust as the recipient for these gifts. Certain types of trusts can be tax-efficient vehicles for transferring wealth.

To demonstrate the power of annual gifting, assume a couple has three children. In 2009, this couple can transfer up to \$26,000 per child or \$78,000 to all three children. If each child has a spouse, the maximum amount that can be given to the children and their spouses is \$156,000 without incurring a taxable gift. If the couple has grandchildren, their ability to further reduce their taxable estates through annual gifts increases.

Planning tip # 2: If your child has earned income, consider making a cash gift. Your child may use that gift to contribute \$5,000 (2009 amount, adjusted for inflation) or the amount of the child's earned income, whichever is less, to a traditional IRA or Roth IRA. Funds contributed to a Roth IRA will grow tax deferred, and qualified distributions will be tax free for federal income tax purposes. Funds contributed to a traditional IRA may be deductible for income tax purposes by your child.

Planning tip # 3: Certain payments made directly to providers of medical and educational services are not treated as taxable gifts to the recipients of these services. For example, a grandmother who wishes to help pay for a granddaughter's education can write tuition checks directly to the school without making a taxable gift. If she writes the check to the granddaughter, however, she will have made a taxable gift to the extent the amount gifted exceeds the \$13,000 annual exclusion. Tuition is not limited to college tuition; any school tuition qualifies for this exclusion. Medical does not just mean doctors and hospitals; any medical expense, including insurance, can be paid under this exclusion.

Planning tip # 4: Fund a Section 529 educational plan for children and grandchildren. Using a special election, you can fund up to five years of annual exclusions into these plans. In 2009, you could contribute \$65,000 to one grandchild's Section 529 plan without incurring a taxable gift or a GST tax (discussed further below). If you make other gifts to that grandchild during 2009-2013, however, those gifts would use some of your \$1 million lifetime applicable gift tax exclusion amount as well as some of your lifetime GST tax exclusion, so think ahead. By funding these plans in advance, the growth in the fund occurs in a tax-exempt environment.

Estate tax

Estate taxes are a big concern for many because the combined effective estate tax rate can be in excess of 50 percent once state estate and inheritance taxes are considered. With proper planning, however, you may reduce your estate tax bill. The estate tax applicable exclusion amount permits the transfer of up to \$3.5 million free of estate tax in 2009. The top tax rate is 45 percent. With the sunset of the estate tax provisions of the 2001 Tax Act, the estate tax is set to be repealed in 2010, but then reappears in 2011 with an applicable exclusion amount of \$1 million and a top rate of 55 percent.

Qualified transfers to a spouse who is a U.S. citizen are covered by the unlimited marital deduction, so such transfers may be made totally free from estate tax. If your spouse is not a U.S. citizen, the estate tax marital deduction is not generally allowed unless the assets are placed in a special qualified domestic trust as discussed later. For non-U.S. citizens not domiciled in the United States, only \$60,000 of U.S. situs assets is exempt from estate tax. As previously mentioned, if either you or your spouse is not a U.S. citizen, it is imperative that your estate planner be made aware of this fact. Treaty provisions may provide for additional tax-free amounts that can be transferred to a non-U.S. citizen spouse.

Wealth transfer tax

To the extent that the taxpayer's applicable exclusion amount is used for lifetime gifting, the amount available for use against the estate tax is reduced. The extent of that reduction is a function of a number of factors, including the amount and year of gift for those lifetime transfers. Caution: It should never be assumed that if a taxpayer makes lifetime gifts of \$1 million, he or she will have the equivalent of the \$2.5 million exemption available to use at death if he or she dies during 2009.

In its simplest manifestation, the taxable estate is determined by taking the aggregate value of all includible assets, reduced by all allowable exclusions and deductions, and increased by the taxable gifts made by the decedent after 1977. A tentative tax is then computed on the taxable estate. Assuming no prior gift tax was actually paid, this tentative tax is then offset by the applicable credit amount, \$1,455,800 in 2009 — the tax computed on \$3.5 million under the current tax rate structure. Thus, any estate where the tentative tax is less than the applicable credit amount generally will not be subject to any federal estate taxes. State death or inheritance taxes may have to be paid in addition to federal tax. Most states that have an estate tax have an applicable exclusion amount smaller than the federal applicable exclusion amount. Consequently, state estate and inheritance taxes may be payable even when there is no federal estate tax liability.

Generally, upon the death of an individual, the assets included in the decedent's taxable estate take an income tax basis equal to their respective fair market values at the date of death. The step-up recognizes that the property value already has been taxed in the estate. This step-up is not available for deferred income assets including, but not limited to, installment notes receivable, deferred compensation plans, pension plans, and regular IRAs.

Planning tip # 1: Review wills and trust agreements. Changes made by the 2001 Tax Act may produce unwanted results if your documents were drafted prior to the change in law. For example, assume your net worth is \$7 million and you die in 2009. If a credit shelter trust (also known as a bypass trust) is to be established and funded upon your death for the benefit of your minor children, and your will states that the trust should be funded up to the applicable exclusion amount, you would leave (assuming no prior taxable gifts) one half of your entire estate to your minor children and only one half to your surviving spouse. This result may not be what was intended when your estate planning documents were originally drafted.

Planning tip # 2: Trusts serve a variety of purposes; indeed, the flexibility of trusts is perhaps the major reason they are so widely used in estate planning. A trust can help take full advantage of the combined benefits of the marital deduction and the applicable exclusion amount, while assuring that all necessary assets can be available to meet the needs of the surviving spouse. A simple estate plan under which everything passes to the surviving spouse may eliminate any taxes in the estate of the first to die; however, additional taxes may be due at the death of the surviving spouse, which could have been avoided had the first spouse to die planned more effectively. To manage the effectiveness of your estate plan, your will could leave all of your assets to your spouse, except the amount equal to the applicable exclusion amount. This amount would go into a credit shelter trust for the benefit of your spouse and family. Although your spouse would be able to benefit from your entire estate, the credit shelter trust assets would not be included in the estate of the surviving spouse on his or her subsequent death.

Generation-skipping transfer tax

The GST tax is imposed on transfers during life and at death that are made to a “skip person” — a recipient who is at least two generations younger than the donor or decedent, such as a grandchild. If there were no GST tax, a gift to a grandchild would be subject to the gift or estate tax once, while a gift to a child who then gifts or bequeaths those assets to a grandchild would be subject to tax twice. Essentially, the GST tax was intended to tax the gift to the grandchild twice at the time it is made, to compensate for the otherwise skipped level of tax. The GST tax, when applicable, is a tax that is imposed in addition to the gift or estate tax; thus, a single transfer may be subject to double taxation.

For GST purposes, when a gift or bequest is made, the focus is on the relationship of the transferor and the transferee and not their age difference. For example, you may have siblings who are significantly younger than you and who, therefore, have children who are significantly younger than you or your children. A transfer to a nephew who is 40 years your junior is not subject to GST tax because your nephew is only one generation younger than you. Conversely, a transfer to a grand-nephew who is only 30 years your junior is subject to GST tax because your grand-nephew is two generations younger than you. Married individuals are considered to be in the same generation, regardless of the difference in ages between the spouses.

When the transferee is not related to the donor, their difference in age becomes important. If you transfer assets to a friend who is less than 12 years younger than you, that friend is considered to be in the same generation as you and not a skip person. If your friend is more than 12 years, but less than 37-1/2 years younger than you, that friend is considered one generation younger than you, and is, therefore, not a skip person. If your friend is more than 37-1/2 years younger than you, your friend is considered two generations younger than you, and is, therefore, a skip person.

There is also an annual exclusion amount available for transfers subject to GST. The GST tax annual exclusion is \$13,000 per recipient per year in 2009, adjusted for inflation. This amount is expected to remain at \$13,000 for transfers made in 2010. Unlike the gift tax annual exclusion, the GST tax annual exclusion is very limited for gifts to trusts.

The exemption amount permits the transfer of a certain amount of assets free of GST tax. The current GST exemption is the same as the estate tax applicable exclusion amount of \$3.5 million. The GST tax rate is equal to the maximum federal estate tax rate for the year of the transfer. Like the estate tax, the GST tax is set to be repealed in 2010, but then reappear in 2011 with an exemption equivalent amount of \$1 million, adjusted for inflation (i.e., approximately \$1.4 million by 2011), if the 2001 Tax Act is allowed to expire.

Planning tip # 1: Grandparents wanting to make a substantial gift to a grandchild should consider establishing a minor’s trust, also known as a Section 2503(c) trust. Gifts to a minor’s trust qualify for both the gift and GST tax annual exclusions. For example, a married couple can transfer up to \$26,000 per year to each grandchild without incurring gift or GST tax. The property and associated income must be available for distribution before the grandchild attains age 21, and, generally, any remaining balance must be distributed to the grandchild at age 21. Another type of trust sometimes used for gifts to minors, known as a Section 2503(b) trust, requires all income from the trust to be distributed annually but does not require the property to be distributed to the grandchild at age 21. Note, however, that a \$13,000 gift to a Section 2503(b) (gift tax annual exclusion) trust for the benefit of a grandchild may not be fully excludable by the gift tax and GST annual exclusions. These limitations may be overcome if the trust contains special additional provisions (under Section 2642(c)) to qualify the gift for the gift tax and GST tax annual exclusions.



Wealth transfer tax

Planning tip # 2: A dynasty trust, described further below, is a trust designed to skip multiple generations, thus more fully exploiting the benefit of the GST exemption. A dynasty trust is used to transfer income to multiple generations while paying estate or gift tax only at the initial transfer to the trust, thus avoiding both estate tax and GST tax at each subsequent generation. Dynasty trusts may also offer significant asset protection from creditors. Although gift tax annual exclusions may be available when funding a dynasty trust, GST tax annual exclusions will not be available, so the donor's unused GST exemption will be allocated when these trusts are funded.

Dynasty trust

Dynasty trusts are available in all states, but laws in many states limit the duration of the trust to 80 to 110 years after they are created. Most states allow the trust to continue until 21 years after the death of the last descendant of the trust creator who was living at the time of the trust's creation. Other states have recently amended their trust statutes to permit trusts to exist into perpetuity. An individual may create a trust in a state other than his or her state of residence.

For example, a couple — neither of whom has previously made taxable gifts — funds an irrevocable dynasty trust with \$1 million each. No gift or GST tax is due upon funding the trust because each of them used their available gift tax applicable exclusion amounts and their GST exemptions. Assume the trust has an after-tax growth rate of four percent, and that all trust income is distributed to the beneficiaries annually. After 110 years, the trust is worth approximately \$149.5 million. Under present law, there are no transfer taxes due on distributions during the duration of the trust or distributions of trust assets when the trust terminates.

Cross-border wealth planning considerations

Non-U.S. citizens — both resident and nonresident aliens — may be subject to U.S. estate and gift taxes. Non-U.S. citizens who live, work, or merely own property in the United States must be prepared to address these issues with respect to both lifetime gifts and bequests at death.

What to consider when moving to the United States.

Upon obtaining a U.S. permanent residency visa, or green card, the recipient will be subject to U.S. income tax on worldwide income (even if living outside the United States), and it likely will subject him or her to U.S. estate and gift tax on worldwide assets if he or she makes gifts or should die while holding the green card.

Surrendering the green card restores nonresident alien status for U.S. income tax purposes (assuming the individual does not spend substantial time in the United States under a nonimmigrant visa and becomes a U.S. resident under the substantial presence test). Upon surrendering the green card, the individual will need to consider whether he or she is subject to the exit tax. The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) imposes a mark-to-market exit tax on certain U.S. citizens who expatriate and long-term green card holders who relinquish their green cards after June 16, 2008 (a covered expatriate). The HEART Act also imposes a tax on U.S. citizens or residents who receive certain gifts or bequests from covered expatriates.

Under the HEART Act, a covered expatriate is a person who renounces U.S. citizenship or who relinquishes a green card after holding it in at least eight of the last 15 years and who: (1) has an average annual net income tax liability for the five preceding years of more than \$145,000 (2009 amount, adjusted for inflation), (2) has a net worth of \$2 million or more, or (3) fails to certify compliance with U.S. tax obligations for the prior five years. Under the exit tax, covered expatriates are treated as having sold their worldwide property in a fully taxable transaction on the

day before their expatriation date. Certain types of assets (e.g., deferred compensation) are excluded from the deemed sale and instead a withholding regime applies to post-expatriation distributions. Covered expatriates must pay tax on all the hypothetical gains resulting from such deemed sale to the extent they exceed \$626,000 (2009 amount, adjusted for inflation).

Estate taxes. A person is considered to be domiciled in the United States (i.e., a U.S. resident alien for estate and gift tax purposes) if he or she lives in the United States with no present intention of leaving the country.

A facts-and-circumstances test is used to determine domicile and takes into consideration the following factors:

- Statements of intent (in visa applications, tax returns, wills, etc.).
- Length of U.S. residency.
- Whether the person has a green card.
- Style of living in the United States and abroad.
- Ties to domicile of origin (birth nation).
- Ties to country of citizenship.
- Location of business interests.
- Place where club and church affiliations, voting registration, and driver licenses are maintained.

A person is considered a non-U.S. domiciliary (i.e., a nonresident alien) for estate and gift tax purposes if he or she is not considered a domiciliary under the facts-and-circumstances test described above. Residency for estate and gift tax purposes is determined differently than residency for income tax purposes; thus, a person may be a resident alien for income tax purposes but a nonresident alien for estate and gift tax purposes. Also, due to the subjective nature of this determination, it is often difficult to determine an individual's domicile for U.S. estate and gift tax purposes with any degree of certainty. It is, therefore, important to consult with an international estate planning advisor in order to determine any potential U.S. estate tax exposure and implement appropriate planning steps.

U.S. domiciliaries are taxed on the value of their worldwide assets actually owned or deemed owned at death, in the same manner as U.S. citizens. Non-U.S. domiciliaries are taxed only on the value of their U.S. situs assets. Generally, U.S. situs assets include real and tangible personal property located in the United States and stock of U.S. corporations. Note that the definition of U.S. situs assets may be modified by an applicable estate and gift tax treaty. Non-U.S. domiciliaries are generally allowed a reduced estate tax exemption amount, which permits only \$60,000 of U.S. situs assets to be transferred free of U.S. estate tax. Again, note that this amount may be increased by an applicable estate and gift tax treaty.

Generally, the amount of jointly owned property that is taxed in the estate of a non-U.S. citizen is based upon who provided the consideration to purchase the property (i.e., whose assets were used to purchase the property). The portion of the property included in a decedent's estate is calculated based on the portion of consideration that the decedent furnished for the property. Special rules apply to community property or property purchased with community funds. Special rules also apply if the surviving spouse is a U.S. citizen.

Every country applies different standards to determine domicile. As a result, it is possible that two or more countries will consider the same person a domiciliary. In that case, such person could be subject to estate tax in both countries. Proper planning along with treaties and foreign tax credits may eliminate or reduce double taxation.

If a decedent's surviving spouse is a U.S. citizen, there is an unlimited marital deduction. In other words, an unlimited amount of assets can pass to the surviving spouse without being subject to U.S. estate tax. On the other hand, if the surviving spouse is not a U.S. citizen, the marital deduction is generally not allowed unless the U.S. property passes through a qualified domestic trust (QDOT). Some estate and gift tax treaties allow for some form of a marital deduction in cases where such a deduction would not normally be available.

Wealth transfer tax



The United States currently has estate and gift tax treaties with the following 17 countries: Australia, Austria, Canada, Denmark, Germany, Finland, France, Greece, Ireland, Italy, Japan, Netherlands, Norway, Republic of South Africa, Sweden, Switzerland, and the United Kingdom.

Gift tax. U.S. gift tax is imposed on taxable gifts made by U.S. citizens, U.S. domiciliaries, and non-U.S. domiciliaries, as follows:

- U.S. citizens and domiciliaries are subject to gift tax on all transfers of property, regardless of where the property is located.
- Non-U.S. domiciliaries are subject to U.S. gift tax only on transfers of tangible personal property situated in the United States and real property situated in the United States. All gifts of intangible property, such as stocks and bonds, made by a non-U.S. domiciliary are not subject to U.S. gift tax.

For 2009, an annual exclusion exempts up to \$13,000 per donee per year of present interest gifts from U.S. gift tax (the \$13,000 is adjusted for inflation and is expected to remain at \$13,000 for 2010). U.S. citizens and domiciliaries can gift split, which, in effect, allows a married donor to exclude up to \$26,000 per donee per year. However, if either spouse is a non-U.S. domiciliary, gift-splitting is not permitted. The \$13,000 annual amount is increased for gifts to a non-U.S. citizen spouse to \$133,000 per year in 2009 (indexed each year for inflation). In contrast, an unlimited amount can be transferred to a spouse who is a U.S. citizen pursuant to the unlimited gift tax marital deduction.

It is important to note that a QDOT may not be used to obtain a gift tax marital deduction for transfers made to a non-U.S. citizen spouse during life. However, an applicable estate and gift tax treaty may allow for some form of a marital deduction in cases where such a deduction would not normally be available. There is no gift tax exemption equivalent amount available for lifetime transfers by non-U.S. domiciliaries other than the annual exclusions discussed above.

Family wealth planning in a low interest rate environment

Interest rates have been lower recently than they have been for several decades. Low interest rates can dramatically improve the wealth transfer results derived from several of the most popular family wealth transfer planning techniques. Every month, the IRS issues what is known as the Section 7520 rate — the rate used for the month in which a gift or death occurs to calculate the gift- or estate-tax value of any actuarial interest in property (i.e., annuity, life estate, an interest for a term of years or remainder interest). The IRS generally releases the rate for the following month approximately two weeks prior to the beginning of that month. Taxpayers, therefore, have the advantage of limited foresight — for example, they will know in mid-November whether rates will rise or fall in December.

Following is a brief list of family wealth planning techniques that work well in a low interest rate environment.

Grantor retained annuity trust (GRAT). A GRAT is an irrevocable trust into which the taxpayer (the grantor) transfers appreciating assets and retains an annuity for a term of years, generally for a minimum of two years. Properly structured, the GRAT allows a taxpayer to move future appreciation of an asset in excess of the Section 7520 rate to another person free of gift tax. The reason the transfer can be accomplished free of gift tax is that the retained annuity interest is not treated as a completed gift. Thus, an annuity structured to have a net present value almost equal to the fair market value of the assets transferred to the GRAT will result in only a nominal gift — the nominal value of the remainder interest. Structured in this manner, all that will remain in the GRAT at the end of the annuity term will be any appreciation in the GRAT assets in excess of the Section 7520 rate — the rate used to net present value the annuity. All other assets, by definition, are returned to the grantor as annuity payments. If there are assets remaining in the GRAT at the end of the annuity term, they can either be retained in

trust for the trust's remainder beneficiary(ies) or distributed outright to such beneficiary(ies), including another existing trust. Ideal assets for funding a GRAT include publicly traded stock that is depressed in value and has reasonable prospects of rebounding within the next two or more years; stock in a company planning an IPO, sale, or other merger or acquisition in the near future; or, any other asset that is expected to rise in value and/or produce income at a rate greater than the Section 7520 rate. The operational downside risk of a GRAT arises from the retained annuity. Specifically, by virtue of the retained annuity, if the grantor should die while still collecting annuity payments, most if not all of the value of the GRAT on the date of death will be included in the grantor's taxable estate.

Planning tip: Use an escalating GRAT. The escalating feature increases the annuity amount up to 20 percent each consecutive year. In general, assuming assets will generally appreciate over time, increasing annuity payments can produce more value for the beneficiaries at the end of a term than constant annuity payments simply because more of the GRAT's assets remain in the GRAT for a longer period of time. For example, an individual funds a two-year GRAT with \$2 million of stock. The grantor believes the stock will recover from the current stock market conditions, with appreciation of eight percent this year and 30 percent in the second year. Assume the current Section 7520 rate is four percent, and the annuity payments are made at the end of each year. The first-year annuity is 48.286 percent of the GRAT's initial fair market value, resulting in a required payment on the first anniversary date of \$965,717. The trust provides for a 20-percent increase in the annuity payment, so the annuity rate for year two is 57.943 percent of the GRAT's initial fair market value, and the corresponding payment on the second anniversary date is \$1,158,860. At the end of the two years, the remainder of \$393,708 passes on to the beneficiaries free of gift tax. If the grantor had selected a level-payment GRAT, the remainder would be \$369,105 — an amount that is 6.25 percent less than the result obtained through graduated payments.

Wealth transfer tax

Intra-family loans. A taxpayer may loan funds to children, other family members, or a trust for their benefit under a promissory note that bears a stated interest rate that is not less than the Applicable Federal Rate (AFR) for the term of the note. The AFR, like the Section 7520 rate, is also released monthly by the IRS.

Although the AFR is usually lower than commercial interest rates, the difference in rates is not a gift. The loaned funds can be used by the taxpayer's children or a trust for their benefit to acquire assets that are expected to generate income and/or appreciate faster than the stated rate on the borrowed funds; thus, the income or appreciation in excess of the stated interest rate on the loan inures to the benefit of the children without being subject to the gift tax.

The note can be structured with flexible terms. For example, the note may be structured as an interest-only note with a balloon payment at the end of the term. If otherwise desirable, the loan can be used to provide current income to the lenders. For example, assume the taxpayer's child is interested in purchasing a home but does not qualify for a commercial mortgage. The taxpayer, acting as the mortgage lender, may loan the necessary amount to the child at the AFR with required monthly mortgage payments. If this rate is lower than commercial rates, the child saves on the rate differential. The rate also may be higher than the rate the lender receives through a savings account, money market account, or on certificates of deposit; thus, the taxpayer benefits through higher interest income.

Consideration should be given to whether the loan term should be long term (a period greater than nine years), mid term (a period of between three years and nine years), or short term (a period of three years or less). Short-term loans generally will have lower AFR rates; however, the borrower is at risk of rate increases to the extent the loan is still outstanding at the end of the term and must be renewed.

The lender should document the borrower's ability to repay the note, and the lenders must intend to enforce and collect the note. Intra-family loan transactions, although not giving rise to a reportable gift, should be disclosed on a gift tax return as a nongift transaction in order to begin the gift tax statute of limitations.

Installment sales. Installment sales allow a taxpayer to sell an interest in property to trusts or other family members for a combination of cash and an installment obligation. As long as the sale is for the property's fair market value, no adverse gift or estate tax consequences arise on the sale. The installment debt is generally included in the taxpayer's estate at its face value should death occur before the note is paid in full, and future appreciation of the property sold generally passes to heirs free of gift, estate, and GST taxes (if sale is to a skip person or GST Exempt Trust).

The income tax consequences of a sale to most trusts or family members are the same as if the sale were to a third party; taxable income will be recognized as payments are made on the note. Publicly traded securities cannot be sold on the installment method, and special rules apply if the purchaser resells the property within two years after the purchase. However, sales made to trusts having certain powers reserved to the grantor may escape the income taxation of sale and the related note payments. These trusts, known as grantor trusts, can create complicated income tax and estate tax interactions. Establishing and transacting with such trusts requires the assistance of an experienced tax advisor.

Insurance and wealth planning

Insurance, in many forms, remains a vital part of all planning activities. This is especially true of life insurance, which involves an ever-changing landscape of product offerings. The following section serves as a guide through some of the considerations that need to be made when planning with life insurance and integrating life insurance into your wealth transfer planning strategies.

Issues to consider in life insurance planning

For many, certain areas of wealth transfer planning, including life insurance planning, were put on hold following the passage of the 2001 Act due to the anticipation and uncertainty of the ultimate repeal of the estate tax. The thought was that if the repeal became permanent, there would be no need for life insurance to cover estate tax obligations.

While there is no absolute certainty yet, all indicators point to a robust estate tax well into the future; therefore, it may be time to reassess the adequacy of insurance coverage and adjust estate plans accordingly. A reassessment may mean reducing coverage or, more likely, moving forward with life insurance purchases that were postponed in the wake of the Act's passage. You and your life insurance advisor should review life insurance plans periodically to account for life changes and any modifications in your wealth transfer planning that have altered your life insurance needs.

Planning tip # 1: Consider purchasing an inexpensive convertible term life insurance policy now to lock in insurability and protect against negative changes in health in the future. When the estate tax laws are settled, the term policy can be converted to permanent coverage in the future.

Planning tip # 2: Review your premium funding strategy on existing policies. Most nonvariable life insurance policies were sold assuming a nonguaranteed interest rate would be credited in all future years. Variable life insurance policies were sold assuming a positive gross investment rate of return would be earned annually. The premium strategy developed at the time the policy was sold was based on — and usually relied upon — the realization of those assumptions. With interest rates falling over the past several years and with the decline in the stock market, most life insurance companies have reduced their dividend scales and the interest rates credited to their policies. As a result, the original premium strategy may no longer be adequate to keep an individual's life insurance policy in effect for the insured's lifetime.

Planning tip # 3: A policy owner should request from the life insurance company an "in-force illustration" to re-project the policy's performance under revised interest assumptions and consult with an insurance advisor to adjust the premium payment strategy as needed.

The role of life insurance in wealth transfer planning.

Often, it takes a variety of wealth transfer techniques to reduce the estate tax burden to an acceptable level. While life insurance provides standalone leverage against estate tax liabilities, it also can have a role in enhancing other planning techniques.

As mentioned above, one drawback to a GRAT is that if the grantor does not survive the annuity term, the GRAT assets are typically included in the grantor's estate, thus causing the GRAT to have accomplished nothing in terms of wealth transfer. Life insurance can be used to offset the impact of premature death within a GRAT structure. Assuming the remainder beneficiary of the GRAT is a trust, that trust could hold a life insurance policy on the grantor. If the grantor survives the annuity period, the remaining GRAT assets will flow to the remainder trust as planned; if the grantor does not live to the end of the annuity period, the life insurance proceeds will be available to the remainder trust and its trust beneficiaries to accomplish the desired wealth transfer goal.

Planning tip: Think "outside of the box" — life insurance can augment many different wealth transfer techniques, sometimes at a lower cost and with less complexity than the alternatives.

Using life insurance to equalize distributions in estates where assets are difficult to divide.

Depending on the nature of your assets, you may find that it is extremely difficult, if not impossible, to divide your estate equitably among heirs. This difficulty may be due to the ownership of an operating business in which all heirs either do not or cannot participate, or other complicating factors.

When faced with what would appear to be an insurmountable issue, the simplest and most cost-effective solution may be purchasing life insurance and naming the otherwise disenfranchised party as beneficiary, either directly or through the use of a trust.

Wealth transfer tax

The irrevocable life insurance trust: an often-used wealth transfer tool for gifts to surviving spouses, children, and grandchildren. A successful irrevocable life insurance trust can pass wealth to future generations on a tax-favored basis. The mechanism is straightforward in concept: Money is placed in trust through annual gifts or other funding mechanisms. The trust purchases a life insurance policy, usually on the life of the grantor. At death, the life insurance proceeds are paid to the trust and used for the benefit of the intended heirs.

The benefit of the structure is that the life insurance proceeds are received income tax free by the trust and are not includable in the estate of the grantor. If structured properly, the proceeds also may avoid GST taxation.

Planning tip: As with other planning methods, there are a number of ways to fund the trust: Direct gifts from the grantor, making the trust the remainder beneficiary of a GRAT, or using a private split-dollar arrangement.

Accessing cash value accounts within life insurance policies requires careful planning. Much has been made of the income tax advantages of life insurance, and for good reason. If structured properly, life insurance policies enjoy several income tax advantages, including the deferral of income tax on the cash value growth, the ability to access cash value amounts through tax-free loans, and the ultimate receipt of death proceeds income tax free.

Careful planning is needed when determining the amount of cash value that can be accessed safely. If the owner takes too much cash from a policy through policy loans, the policy will not have sufficient money to stay in force and it will lapse. Upon the lapse of a life insurance policy, any gain from monies received in excess of cumulative premiums paid will be taxable at ordinary income tax rates.

Planning tip: When purchasing a policy with an eye toward investment, have the broker illustrate how the policy will perform assuming cash is taken out of the policy through loans and/or surrenders. In addition, have the illustration run at multiple rates of return to show what will happen in varying economic environments.

Split-dollar life insurance. A split-dollar life insurance arrangement is a mechanism whereby one party helps another party fund the purchase of a life insurance policy. In the past, split-dollar life insurance had been used in the corporate benefits arena, with the employer helping an employee to purchase coverage. It also had been used in the wealth transfer arena, with a grantor helping to fund the purchase of a life insurance policy held by an irrevocable life insurance trust.

IRS regulations issued several years ago greatly curtailed the use of split-dollar arrangements within the corporate benefits arena due to the elimination of the ability to pass large amounts of cash value growth to employees at a minimal tax cost. When making gifts in trust, however, the ability to reduce gift tax costs may still make split-dollar life insurance a viable premium financing and wealth transfer technique in the proper setting.

The planning issues around split-dollar arrangements are rather complex. It is important to consult your tax and insurance advisors before entering into a split-dollar transaction.

Planning tip: Split-dollar arrangements that stay in place for an extended period of time often experience increasing tax costs, requiring that you give thought to exit strategies before putting such an arrangement in place.



The secondary marketplace for life insurance

products. Sometimes the owner of a life insurance policy outgrows his or her need for coverage. This could result from the sale of a business, changes in family dynamics as children leave home, or a change in marital status. In the past, the only option available to the policy owner was to surrender the policy to the issuing company for the policy's cash value. Now, a secondary marketplace exists where life settlement companies stand ready to purchase unwanted policies, often at a price considerably higher than the policy's cash value.

The actual purchase price offered by a life settlement company will depend on a number of factors:

- The insured's age — most companies require the insured to be at least in his or her late 60s.
- The insured's health — a negative change of health since the policy was issued increases the value of the policy to the life settlement company.
- The policy cash value — lower cash values are more attractive to life settlement companies, including term policies with zero cash value.

There are a number of issues to consider when determining if such an arrangement is appropriate in a given case, including the continuing requirement to provide health information to the new policy owners, and the potential income tax considerations related to any money received in excess of the owner's basis in the policy. Before entering into a life settlement transaction, consult with your tax advisor to determine the amount and nature of any taxable gain.

Property and casualty umbrella coverage. Umbrella policies are a type of property and casualty insurance designed to provide coverage for catastrophic losses that exceed the base coverage carried to insure a given risk. An umbrella policy cuts across multiple lines of insurance, providing excess coverage for a broad range of potential risks for personal injury claims, ranging from car accidents to accidents in the home.

For example, assume that a person was injured in a car accident for which you were at fault and your car insurance policy has a maximum liability payment of \$1 million. If a judgment is entered for \$2.5 million, you personally would be liable for the additional \$1.5 million payment. If you carried a \$5 million umbrella policy, however, the umbrella policy carrier would step in and pay the additional \$1.5 million liability.

The same result would occur if the accident was related to an injury in your home. The umbrella nature of the coverage crosses insurance lines to give you excess protection across multiple areas of exposure. The very nature of the coverage, however, can make it difficult to determine the proper amount of coverage to carry. In part, the decision should be based on your net worth. That does not necessarily mean an individual with a \$50 million net worth needs \$50 million of umbrella coverage. The two questions to consider in deciding the appropriate amount of coverage are: (1) what is the maximum amount of a judgment that you could pay and not have it negatively affect your lifestyle, and (2) what potential for a judgment exists in the activities in which you and your family regularly engage?

A person with a \$100 million net worth may well feel less compelled to carry a large umbrella policy than a person with a \$10 million net worth because a large judgment would affect the second person more drastically than the first. Similarly, a person who leads a relatively sedentary lifestyle may feel less need to carry a large umbrella policy than a person with two teenage children who enjoy driving sports cars and racing speedboats.

Wealth transfer tax

Charitable gifts

Your charitable goals and desires are a key consideration when contemplating both income tax and wealth transfer tax planning. Since our tax laws encourage gifts to charitable organizations, you can generate significant tax savings by carefully planning, structuring, selecting, and timing your charitable gifts.

Rules, limitations, and reporting requirements.

In the case of a gift of cash, you must maintain a cancelled check, bank record, or receipt from the donee organization showing the name of the donee organization, the date of the contribution, and the amount of the contribution. Payroll deduction records are also acceptable. Gifts of \$250 or more require a contemporaneous, written description of the contribution from the charity in order to qualify for the charitable contribution deduction. A cancelled check is not sufficient to support a deduction of \$250 or more. Note that these requirements also apply to individuals who donate to their family-funded private foundations. The private foundation must provide the donor with contemporaneous written acknowledgment of the gift or the IRS will not allow the charitable contribution. Contributions to non-U.S. charities are not deductible for U.S. income tax purposes. Many U.S. charities work in foreign countries, and donations to them are fully deductible.

Planning tip: Limited deductions are allowed for contributions to charities in Canada, Mexico, and Israel. Consult your tax advisor if you think this might apply to you.

As discussed in the *Income tax* section, any gift in excess of \$5,000, other than cash or stock in a publicly traded company, requires an appraisal from a qualified appraiser in order to qualify for the income tax charitable deduction. There are very specific standards as to what constitutes a qualified appraisal and who is a qualified appraiser. If these standards are not met, the charitable deduction may be denied.

Special rules apply to charitable donations of tangible personal property. In instances where an individual's contribution of tangible personal property will be used by the donee for a purpose that is unrelated to the organization's charitable activities, the amount of the deduction is limited to the lesser of the value or cost basis of the property. This limitation often arises in connection with donations to charity auctions. If the charity uses the donated property in activities related to its tax-exempt purpose, there is a special charitable deduction recapture rule if the charity disposes of the related-use tangible personal property after the close of the taxable year in which the donor made the contribution but before the end of the three-year period beginning on the contribution date.

Planning tip: If you are contemplating a significant donation to a charity auction, avoid disappointment at tax time — consult your tax advisor before the donation.

Charitable gifts of fractional interests in property.

Charitable contributions of less than a taxpayer's entire interest in property (split or fractional interest) are generally not deductible. An example of an impermissible split interest would be to deduct the rental value of property that an individual allows a charity to use without charge. For example, assume an individual donated the right to use a vacation home for one week to an auction held for charity. At the auction, the charity accepted a bid equal to the fair market value of the home for one week. The individual cannot claim a deduction because of the split-interest rule. The purchaser also is not entitled to a donation deduction because the purchaser received full value for the payment.

This general disallowance rule does not apply to certain charitable trusts, a remainder interest in a personal residence or farm, an undivided portion of the donor's entire interest in the residence or farm, and certain transfers made exclusively for conservation purposes.

For fractional interest gifts of art and other tangible property, the gift must be an undivided portion of the donor's entire interest, and the donor (or the donor and donee) must have owned all interests in the property immediately before the contribution. The donee is allowed possession and control of the property during the portion of the year that is representative of their interest. The deduction for the initial contribution is the fair market value at the time of the contribution (assuming related use by the donee) and will be a pro-rata portion of the entire value of the property. The amount of the deduction for additional contributions is based on the lesser of the fair market value at the time of the initial fractional contribution or the fair market value at the time of additional contribution.

Any deduction for a fractional interest gift of art or other tangible property has to be recaptured, with interest, if the donor fails to contribute all of the remaining interests in the property to the donee before the earlier of the tenth anniversary of the initial fractional contribution or the donor's date of death. Recapture also is necessary if the donee fails to take substantial physical possession or fails to use the property in a related manner during the period beginning with the initial fractional contribution and ending on the earlier of the tenth anniversary or the donor's death. A deduction is allowed for the contribution of a partial interest in real property to a qualified organization exclusively for conservation purposes. Conservation purposes include:

- The preservation of land areas for outdoor recreation and education.
- The protection of natural habitat of fish and wildlife.
- The preservation of open space for scenic enjoyment.
- The preservation of a historically important land area or a certified historic structure, pursuant to federal, state, or local governmental conservation policy.

To be eligible for a deduction, the conservation purpose must be protected in perpetuity and may be an easement or other interest that under state law has attributes similar to an easement. The value of a perpetual conservation restriction is the fair market value at the time of the contribution.

A charitable contribution deduction for facade easements is limited to buildings located in a registered historic district and structures, buildings, or land areas if listed on the National Register. Some visual public access is required; if there is no visibility from a public way, the terms of an easement must be such that the general public is given the opportunity on a regular basis to view the property preserved by the easement to an extent consistent with the nature of the property.

Planning tip: An appraisal by an appraiser experienced with conservation easements is essential for sustaining a deduction for a conservation easement because the value of the easement is usually of such a magnitude that the appraisal must be attached to the donor's return.

Planned giving. The term "planned giving" refers to charitable gifts that require some planning before they are made. Types of planned gifts include charitable trusts and gift annuities. Charitable trusts may have both charitable and noncharitable beneficiaries.

Charitable remainder trust (CRT). A CRT is a trust that provides an annual payout to a noncharitable beneficiary (e.g., the donor), with the remainder going to a charitable beneficiary at the end of the trust term. The term can be for the donor's (or donor's and spouse's) lifetime, or for a fixed term not to exceed 20 years.

Planning tip # 1: CRTs are income tax-exempt entities; thus, they generally pay no tax on income generated from the trust's assets. Donors often fund CRTs with highly appreciated property, have the trust sell the property, diversify, and reinvest 100 percent of the proceeds, and then enjoy the benefit of a lifetime payout from the income (and principal, if necessary) derived from the reinvested proceeds.

Planning tip # 2: Individuals other than the donor and his or her spouse can be beneficiaries of a CRT; however, the value of an interest in a CRT given to someone else is generally a taxable gift or bequest.

Wealth transfer tax

Charitable lead trust (CLT). A CLT is a trust that provides an annual payout to one or more charitable beneficiaries, with the remainder going to a noncharitable beneficiary. The annual payout can be either a fixed amount or percentage based on the initial fair market value of the trust or a fixed percentage of the fair market value of the trust's assets valued annually. CLTs are not tax-exempt, but they are allowed a deduction for the amounts paid to the charity each year.

Planning tip # 1: CLTs are used for charitable planning in conjunction with wealth transfer planning. A donor can transfer a remainder interest in a CLT to family members at a low gift-tax cost.

Planning tip # 2: The term of a CLT, unlike for a CRT, is not limited to 20 years; therefore, a CLT could be set up to pay to charity until the beneficiary's expected retirement date.

Whether a charitably inclined donor will use a CRT or a CLT depends on the donor's situation. In general, a CLT should be used only by a grantor who has other income-producing assets to provide sufficiently for his or her cash needs during the charitable term, while a remainder trust is useful for a donor who requires a current income stream (or wishes to provide income to another at a reduced gift tax cost) or anticipates having a need for income during the trust term.

Gift annuities. A gift annuity is a contract under which a charity, in return for a transfer of cash, marketable securities, or other assets agrees to pay a fixed amount of money to one or two individuals for their lifetime. The fixed payments (annuity) are fixed and unchanged for the term of the contract. A portion of the annuity payments are considered to be a partial tax-free return of the donor's gift, which is spread ratably over the life expectancy of the individual(s). Unlike an installment sale, a charitable gift annuity can spread the gain on the disposition of marketable securities over a donor's lifetime.

Types of charitable organizations. Qualified charitable organizations have tax-exempt status from the IRS. Each type of charitable organization has advantages and disadvantages. You should work closely with your tax advisor to determine the type of organization that is best for you, your family, and your community prior to establishing one. The type of organization chosen along with the type of property contributed is important because these decisions may affect your charitable contribution deduction limitations.

Public charities. A public charity receives its principal funding from the general public, governmental sources or agencies, or other charitable organizations. It is permitted to solicit funds from the general public. In general, contributions of ordinary income or short-term capital-gain property are limited to basis and may be deducted up to 50 percent of adjusted gross income (AGI), while contributions of long-term capital-gain property are deductible at fair market value and may be deducted up to 30 percent of AGI. As discussed in the *Income tax* section, a donor advised fund (DAF) is a fund that is managed under the tax umbrella of a public charity, such as a community foundation. The donor makes an irrevocable gift of property, such as stock, to the host charity and receives a fair market value tax deduction in the year of the gift. Assets are deposited into an investment account where they can grow tax free. The donors recommend grants from the account to charities they select, with the option of being recognized or remaining anonymous. A number of large financial institutions also have established large multi-donor DAFs. DAFs have become very popular in recent years due to the efficiencies, cost savings, and ease of administration that are gained through the economies of scale derived by pooling thousands of donors' charitable dollars.

Private foundations. A private foundation is a charitable entity formed as a corporation or as a trust by an individual, a family, or a business and for which most, if not all, of the funding will come principally from the creator. The foundation does not expect to solicit funds from the general public. The private foundation offers the donor maximum control over charitable giving and provides an organized structure for a family's charitable activities. In general, contributions of ordinary income or short-term capital-gain property are limited to basis and may be deducted up to 30 percent of AGI, while contributions of publicly traded stock that has been held long term are deductible at fair market value and may be deducted up to 20 percent of AGI. Contributions of other long-term capital-gain assets are deductible at basis or value, whichever is less, and are also limited to 20 percent of AGI.

Planning tip # 1: Publicly traded securities other than stock are only deductible at basis or value, whichever is less, when donated to a private foundation.

Planning tip # 2: For this purpose, stock subject to SEC Rule 144 is not considered publicly traded stock. Consult your tax advisor if you are considering donating this stock to a private foundation or public charity, as it may be possible to eliminate the tax impact of Rule 144.

Planning tip # 3: The tax returns of private foundations, along with most other charities, are available to the public at www.Guidestar.org. Therefore, they are not suitable for anonymous giving.

Planning tip # 4: If you have assets that are currently worth less than their cost basis, sell them, take the tax loss, and donate the cash. If "loss assets" are donated to charity, the loss in value between the purchase date and the date of donation is not deductible.

Planning tip # 5: Use caution when considering a donation of a partnership interest to charity. If there are debts inside the partnership (such as real estate partnerships or many hedge funds), unexpected taxable gain may be triggered by the donation.

Supporting organizations. A supporting organization is a public charity that is organized and operated exclusively to support specified supported organizations, usually other public charities. Examples include the ladies' auxiliary of a hospital, a parents' club at a private school, or a university alumni association. Although treated as public charities for donation purposes, there are special restrictions on their operations. These restrictions should be considered before choosing this organization as an alternative to a private foundation. Donation deduction limitations are the same as for other public charities.



Other planning considerations

With today's market turmoil and new legislative developments on the horizon, we have highlighted for private business owners and individuals with investments in hedge funds, private equity funds, and real estate key developments to be aware of as they monitor their long-term plans. We also have included planning tips and links to useful resources.

Private operating businesses

As many private business owners re-examine their business operations to exploit any opportunities presented, they also need to prepare for potential future developments — a potential slow growth business environment, higher interest rates, higher tax rates, an ever-widening tax base as federal and state governments need to raise revenues, and increased regulatory demands.

Key developments

- The economic upheaval in the last year has presented many difficult marketplace developments for the private business owner, with potentially more to come:
 - Inability to obtain financing or significantly higher rates on available financing.
 - Substantially lower revenues with costs still increasing.
 - Unprecedented federal and state government budget deficits with the prospect of future tax increases.
 - Vendor and customer bankruptcies or substantially lengthened business terms.
 - Reduced business enterprise values.
 - Increased pressures on employee headcount and morale.
 - The enactment of FIN 48 {ASC 740} for private companies effective for years ending on or after December 14, 2008.¹
- Some companies and industries have performed well in the current economic climate, but many have experienced and will continue to experience significant operating stress that challenges enterprise survival, restricts liquidity, threatens growth strategies, and limits shareholder planning.

- While illiquidity and reduced valuations have resulted in fewer financial transactions and an environment less conducive to certain exit strategies for owners, the economic climate has produced almost unprecedented opportunities to transfer equity interests in the business to, or for the benefit of, family members in a very tax effective manner.

Planning tips

- Business owners should consider utilizing GRATs or other time-tested estate tax planning techniques such as sales of equity interests to grantor trusts to manage current gift and future estate taxes. The current low interest rates combined with reduced valuations have created an opportunity where the potential gift- and estate-tax savings to be realized from significant current transfers of interests in otherwise healthy businesses should not be passed up. Higher interest rates, higher valuations, and inevitable changes in the tax law (including proposed changes in the ability to apply marketability and minority discounts to enterprise valuation) may eliminate the ability to make similarly tax effective transfers in the future.
- Business owners should periodically prepare a full personal balance sheet and project the resulting estate-tax liability for a hypothetical death on that date. Determining the availability and prudence of statutory government tax deferral; or, how the hypothetical tax might otherwise be paid (e.g., through asset sales, borrowed funds, or life insurance) and whether future profits will be sufficient to sustain debt service if government deferral or borrowed funds are used to satisfy the tax is always an illuminating exercise.
- Revisit your exit strategies and succession plans. Does or should the current economic environment affect your “sell or grow” decision? If you are predisposed to family succession rather than a disposition of the business, consider that:
 - Perpetuating a multigenerational family business requires one to simultaneously provide independent financial security to older owners while encouraging their transfer of ownership in the business to the

¹ On July 1, 2009 the FASB launched the FASB Accounting Standards Codification (ASC). The codification is the single source of nongovernmental authoritative U.S. GAAP for interim and annual periods ending after September 15, 2009. FIN 48 was codified in ASC 740 along with all of the other authoritative income tax accounting guidance.

- younger generation. This requires coordinating distribution policies and structured redemptions with buy/sell agreements and intra-family sales.
- The success of the family succession process (as ultimately measured by the continuing success of the business) is dependent upon the “buy-in” and participation of multiple stakeholders. An inclusive process that creates a framework to develop strategic priorities is most likely to succeed in the implementation of a comprehensive and integrated plan.
 - The continuing success of the business cannot ignore management transition. Ideally, this should include the execution of management training programs as well as the continuing assessment of compensation programs to properly incentivize management, including the owner.
 - Buy-sell agreements should be relevant and in compliance with the tax considerations governing such agreements. Note that altering pre-1991 buy-sell agreements should not be undertaken until the tax consequences are fully understood since such alterations may jeopardize more favorable grandfathered agreements.
 - Make sure current estate tax planning documents are up to date, including wills, beneficiary designations, revocable trusts, and financial powers of attorney (including stock voting powers), to avoid any conflict with succession plans.
- When considering transfers, evaluate alternative tax-efficient trust ownership structures, especially trusts having grantor trust status. Where S corporations are involved, care must be taken that trust ownership does not inadvertently terminate S corporation status. In addition, state taxation issues should be taken into account. Finally, trust planning must consider generation-skipping planning.
 - With many businesses still operating at a loss, pass-through entities and their owners must pay particular attention to various loss limitation rules, which may defer anticipated tax benefits. Basis limitations, at-risk limitations, alternative minimum tax (AMT) issues, and passive-activity loss rules all need to be considered for flow-through entities.
 - Closely monitor state income tax developments as states deal with budget shortfalls. These include planning for nexus and apportionment issues as well as looking for new credit and incentives as states more aggressively pursue jobs for their constituents.
 - In order for businesses to preserve or generate cash, owners should consider:
 - For 2010 whether to accelerate ordinary income to avoid higher anticipated tax rates in 2011.
 - For 2009, the increase in the expensing limits for certain types of qualified property and the provision for 50-percent bonus depreciation.
 - Also in 2009, C corporations should consider forgoing accelerated depreciation for currently refundable AMT credits and research and development tax credits.
 - For 2009 and 2010, relief for taxpayers who are purchasing or restructuring their debt at a discount, which allows them to elect to defer cancellation of debt income until 2014 and beyond.
 - For 2008 and 2009, the expanded net operating loss (NOL) carryback period to five years for certain small businesses.
 - For 2009, whether the loss of non-business deductions when in a NOL position can be reduced.
 - Reviewing accounting methods, particularly capital expenditure and maintenance policies, to generate additional cash from the tax benefit of the acceleration of deductions or the deferral of income.
 - For 2009 and 2010, whether any of the aforementioned steps will have any adverse consequences under the AMT rules.

Other planning considerations

- Both the Obama tax proposals and current law prescribe increases in the individual ordinary income tax rates, causing some S corporations to challenge whether they will maintain S corporation status in the future. Any such action must be assessed in light of the significant advantages to remaining an S corporation, particularly if the exit strategy is likely to be a sale of the business.
- U.S. flow-through enterprises need to balance the benefits of treating their foreign subsidiaries as corporations vs. disregarded entities. While corporate subsidiaries may result in deferral of lower taxed earnings, those earnings could ultimately result in double taxation, with no foreign tax credit for foreign corporate taxes paid. While a disregarded entity subsidiary eliminates the potential for deferral, it avoids double taxation because the foreign taxes are deemed to have been paid directly by the U.S. owners. This assessment needs to be made in the context of repatriation objectives and opportunities to redeploy foreign earnings offshore with changing tax rules, including the likely increase in U.S. individual income tax rates, the sunset of the 15-percent tax on dividends, and potential changes to capital-gains rates.
- Early planning can help avoid the risk of underestimating the time and resource requirements of FIN 48 {ASC 740} implementation and any unnecessary financial statement delays. Additionally, beginning the implementation process before year-end may bring to light accounting method and other opportunities that, if addressed, could have a favorable impact on the tax return and generate cash today through method changes.

[More resources at www.deloitte.com/us/TaxPlanningGuideResources](http://www.deloitte.com/us/TaxPlanningGuideResources)

- *Sarbanes-Oxley Act of 2002: Can private businesses benefit from it?*
- *Private companies and the financial crisis: The dual imperative... managing risk, preserving cash*
- *Proactive private companies: Taking charge in today's economy*
- *Transferring wealth in a low interest rate environment: A window of opportunity for business owners*
- *President Obama's proposed changes to individual taxes: Considerations for high-net-worth individuals*

Hedge funds and private equity funds

Although structurally hedge funds and private equity funds share many similarities, there are also sharp contrasts that can have significant impact to investors. One similarity is that both funds are typically structured as domestic investment partnerships. One contrast, which was highlighted dramatically in late 2008 and into early 2009, is the permanency of capital of each structure. Unlike private equity funds, which will often operate over a defined period where investors agree to specific capital contributions and investment schedules, hedge funds will most often operate with a lack of any permanent capital. In a typical hedge fund structure, investors have the ability to invest and redeem at periodic intervals. When substantial net redemption activity occurs, as was the case in late 2008 and into early 2009, fund investors might take on risks associated with the fund's investments that extend beyond the fund's portfolio construction. For instance, if a hedge fund holds a combination of liquid public securities, less liquid public securities, and illiquid private equity-like holdings, and if too many other investors redeem, the fund portfolio (and by extension the remaining fund owners) could be left with only less liquid, harder-to-value assets.

According to industry estimates, hedge fund assets decreased from \$1.8 trillion at the end of 2007 to \$1.4 trillion at the end of 2008 and further declined over the first half of 2009.¹ Despite this heavy net outflow of hedge fund assets, the industry is predicted to reach almost \$2.6 trillion by the end of 2013.² One reason for this predicted growth — despite coming off one of their worst performance years in history — is that hedge funds overall fared better than most broad-based indices. During 2008 and, in particular, the fourth quarter of 2008, broad market indices globally witnessed substantial, and in many cases dramatic, decline. The S&P 500 Index ended 2008 off almost 40 percent, rebounding from a trough of almost 50 percent in late November; the Hang Seng, Hong Kong's major index, ended 2008 down over 48 percent; and the Financial Times and the London Stock Exchange (FTSE) 100, an index measuring large UK companies, ended 2008 down over 31 percent. Hedge funds, although also turning

¹ See BNY Mellon commissioned Casey Quirk whitepaper, *The Hedge Fund of Tomorrow: Building an Enduring Firm*, April 2009; http://www.caseyquirk.com/docs/research_insight/2009-04_The_Hedge_Fund_of_Tomorrow.pdf

² *Id.*

in overall negative performance during 2008, on average managed to end the year down just under 20 percent, or just about half of the negative performance of the S&P 500 Index.

With the financial markets and hedge funds performing better over 2009, allocators have started to come back. Net hedge fund inflows were positive in May, June, July, and August³ as investors looked to capitalize on investment opportunities presented in a changing environment.

Key developments

- As market volatility heightened and the credit markets stumbled, both traditional and alternative investment vehicles suffered losses.
- The financial events occurring during late 2008 and into early 2009 provided a backdrop for the introduction of legislative reforms across a broad spectrum of tax and regulatory issues.
- Proposed tax legislation squarely targeted the private equity and hedge fund industries, most notably with an initial version of carried interest legislation which would characterize certain gains from service partnerships as ordinary income.
- The Obama Administration's budget outline was sent to Congress in February of 2009 and in May of 2009 the Obama Administration released the "Green Book," providing additional budget details. Included among the budget proposals were the following tax provisions affecting institutional and individual investors:
 - Beginning in 2011, qualifying dividend income (QDI) would be taxed at 20 percent, up from 15 percent currently.
 - As required under current law, long-term capital-gain rates would be allowed to sunset back to 20 percent in 2011.
 - As required under current law, the current top marginal rates of 33 and 35 percent would be allowed to sunset back to 36 and 39.6 percent, beginning in 2011.
- The benefit for itemized deductions would be capped at 28 percent, such that taxpayers in higher brackets would receive no additional benefit for paying tax at a higher rate than 28 percent.
- In July 2009 a new surtax of up to 5.4 percent was proposed to fund broad health care reforms.
- In July 2009 a report entitled *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* was released. Many of the highlights included in the wide-ranging strategic document focused on combating the underpayment of federal tax relating to offshore transactions and assets. The Obama budget also proposes new reporting requirements, particularly with respect to tax havens. These would enhance information reporting, increase tax withholding, and strengthen penalties to curb offshore tax haven evasion.
 - Individuals would be required to report on their individual tax returns any transfer of money or property to foreign financial accounts — unless, for example, they are held at qualified intermediaries (QIs) — and report receipts from accounts held by U.S. persons at QIs.
 - Individuals also would be required to file a Foreign Bank Account Report (FBAR) and disclose certain information on a schedule that would be part of their income tax return.
 - The budget proposal would establish a rebuttable presumption that any financial account held by a U.S. citizen at a financial institution that is not a QI contains enough funds to require the filing of an FBAR. An exception would apply for accounts held through a QI, and the Treasury Department would be given regulatory authority to provide additional exceptions.
- As the fourth quarter of 2009 approaches, the level of new hedge fund start-up activity has increased. Many strategies, including distressed debt, quantitative focused, and commodities funds are currently preparing to capitalize on market opportunities that have their origin in the financial turmoil of the last year.

³ See http://money.cnn.com/2009/08/21/markets/hedge_funds/index.htm

Other planning considerations

Planning tips

- Before making any new investments in a fund, request the following fund documents:
 - Due diligence questionnaire (DDQ) which should contain, in summarized form, information about a fund's operations and portfolio performance.
 - Full subscription documents, including limited partner agreement and private placement memorandum.
- Carefully review the liquidity parameters and make sure fund lock-up periods are consistent with a fund's investment objectives.
- Make sure tax consequences are fully understood prior to making any new investment decisions. Some key questions to ask in the process are:
 - When will year-end tax reports be made available to investors?
 - Will fund investments trigger offshore reporting requirements, state filing requirements, or the potential for negative deferred tax consequences?
- With portfolio values depressed, shifting ownership of these fund investments within families or to trusts now can be accomplished with reduced income, estate, and gift tax consequences.

More resources at www.deloitte.com/us/TaxPlanningGuideResources

- *2009 Global Trends in Venture Capital Report: New strategies for new economic conditions*
- *Private Equity, Hedge Funds & Mutual Funds*

Real estate

The past year has brought great uncertainty and much gloom to real estate investors, but it has also created opportunities reflective of deep divisions of opinion regarding real estate valuation and prospects for economic recovery. Those who own real estate investments and those considering whether to invest are facing almost unprecedented upheaval in the marketplace.

Key developments

- Effective shutdown of the Collateralized Mortgage Backed Securities (CMBS) marketplace has removed liquidity from the real estate financial sector and reduced the availability of loans to acquire property or to refinance maturing debt. It is expected that \$518 billion in existing debt will mature in the next two years.
- Federal government intervention is beginning to play a role in creating real estate liquidity but not at the pace desired by the industry.
- Commercial foreclosures did not match the pace of residential foreclosures but are predicted to accelerate significantly into 2010.
- Significant consolidation occurred in the banking industry with many old players (Wachovia, Washington Mutual, etc.) being absorbed into other institutions.
- The effects of recession on employment, consumer spending, corporate profits, and other economic drivers resulted in weakening fundamentals in all commercial property sectors.
- Europe's recession is as deep as the United States, but many think the European economy will take longer to turn around.
- President Obama's tax proposals include allowing the current law to sunset the 15-percent long-term capital-gain rate at the end of 2010 with reversion to a 20-percent rate; most prognosticators think the ultimate rate will not exceed 20 percent.
- States are increasingly hungry for funds and looking at real estate sales as a means to raise revenue through transaction fees and increased reach of taxes.
- The recent rebound in the stock value of Real Estate Investment Trusts (REITs) by 52 percent over the first half of 2009 has reduced the overall REIT sector dividend yield from around nine percent to about six percent.
- There are now numerous funds and other investment vehicles coming to market hoping to capitalize on perceived value in the real estate debt that is to be off-loaded by financial institutions.

Planning tips

- Review your real estate portfolio, focusing particularly on debt maturities and loan covenants in view of potential for rental income reductions on lease turnovers.
- Expect longer turnarounds and more work needed for refinancing or new property loan processing.
- Work with financial, legal, and tax advisors to stay current on changing state tax and regulatory environments affecting real estate holdings. Consider ongoing costs of state tax and regulatory compliance when deciding where to invest directly.
- When investing for yield (funds, net leased properties), evaluate sustainability of initial yields in view of tenant credit, sponsor fees, and refinancing risk.
- Consider global opportunities; while capital increasingly ignores borders, arbitrage opportunities still exist. On the other hand, recognize the differences in stability, transparency, and accessibility between U.S. and foreign real estate; and be aware that additional reporting requirements may result from direct (or sometimes indirect) ownership of foreign situs assets.
- With portfolio values depressed, shifting ownership of these investments within families or to trusts now can be accomplished with reduced income, estate, and gift tax consequences.

More resources at www.deloitte.com/us/TaxPlanningGuideResources

- *Prospects for tax reform in the Obama administration: Risks and opportunities for the real estate industry*
- *2009 Industry Outlook: Real Estate*
- *2009 Industry Outlook: Challenging times, emerging opportunities*
- *Real estate tax update: Impact on real estate industry from White House budget proposals*

Incentives for individual taxpayers to go “green”

The “green” movement — promoting enterprise sustainability, clean technology, and renewable energy — is gaining momentum not only across corporate and industrial America, but among individual taxpayers as well. Federal incentives to go “green” may not be as significant for individuals as for commercial enterprises; still, they are worthwhile considering as part of your overall tax and wealth planning, particularly if you expect to face the alternative minimum tax (AMT). One also should not forget state efforts to promote going green. Such efforts take a number of forms and are far more diverse than federal programs, including direct rebate programs in addition to state tax credits or other state tax incentives. Although frequently lacking the scale of federal benefits, specific targeted benefits can be surprisingly generous.

Key developments

The American Recovery and Reinvestment Act of 2009, signed into law on February 17, 2009, includes a number of provisions intended to promote the purchase of nonbusiness energy-efficient residential property by significantly decreasing the net cost of that property to the taxpayer.

First, it increases the current-law credit for purchases of energy-efficiency improvements for one’s principal residence (such as windows, insulation, or doors) from 10 percent to 30 percent under Section 25C, and extends the credit through December 31, 2010. Previously fixed amounts for certain property (e.g., main air circulating fans; natural gas, propane, or oil furnaces; hot water boilers; or energy-efficient building property) were removed, making the full cost eligible for the general 30 percent credit. Additionally, the Act increases the aggregate maximum credit over the life of a taxpayer from \$500 to \$1,500 for 2009 and 2010. Increased energy-efficiency standards apply to eligible property placed in service after December 31, 2009. Note that this credit will offset AMT only in 2009.

Second, the Act removes the maximum individual credit amount limitation under Section 25D for residential energy-efficient property (including solar electric, solar water, fuel cell technology for one's own principal residence, small wind, and geothermal heat pumps) and removes previous requirements to reduce the credit amount for the receipt of subsidized energy financing. Thus, for property placed in service during 2009 and 2010, the full amount of qualifying expenditures is eligible for a 30 percent credit, which is deductible for both regular and AMT purposes.

Considering purchasing an electric vehicle? The Act also modifies the plug-in electric drive vehicle credit to eliminate the prior-law credit limitation based on vehicle weight. The credit ranges from \$2,500 to \$7,500 depending on the battery capacity of the vehicle. The Act also delays the phase-out of the credit to the second calendar quarter after the calendar quarter during which the 200,000th qualified plug-in electric drive motor vehicle is sold in the United States after December 31, 2009. These changes apply to vehicles acquired after December 31, 2009. Lastly, the Act creates a new credit for 10 percent of the cost for low-speed vehicles, motorcycles, and three-wheeled vehicles purchased after the date of enactment of the Act but before January 1, 2012. This credit is limited to \$2,500.

For those taxpayers considering converting a motor vehicle to a qualified plug-in electric drive vehicle, the Act creates a new Section 30B(h) credit. The credit is equal to 10 percent of the expenses associated with the cost of converting any motor vehicle to a qualified plug-in electric drive vehicle (provided that conversion costs do not exceed \$40,000) before December 31, 2011. This credit is allowed even if other credits have already been taken for the specific motor vehicle in preceding tax years. The Act also provides that this credit is part of the alternative motor vehicle credit, which is the sum of the qualified fuel cell, advanced lean burn technology, qualified hybrid, and qualified alternative fuel motor vehicle credits. Finally, the Act allows the alternative motor vehicle credit against the AMT.

In addition, the Act also increases the maximum credit for nonbusiness property used for nonhydrogen alternative fuel vehicle refueling from \$1,000 to \$2,000.

Planning tips

- If you intend to take a credit for residential purchases of energy-efficiency improvements, you should obtain a certification statement from the manufacturer that the purchase is qualified energy property and satisfies the requirements of Notice 2009-53. Taxpayers can rely on such certifications and do not have to attach the certification to their tax returns. However, installation of the property must be consistent with the certification, and you must maintain books and records that are sufficient to establish entitlement to, and the amount of, any credit.
- If you expect to be in an AMT position in future years and have been considering converting your motor vehicle to a qualified plug-in electric drive vehicle, you may want to take action before December 31, 2011, in order to take advantage of the new Section 30B(h) credit. The credit is equal to 10 percent of the expenses associated with the cost of converting any motor vehicle to a qualified plug-in electric drive vehicle (provided that conversion costs do not exceed \$40,000).

More resources at www.deloitte.com/us/TaxPlanningGuideResources

- *First Steps: An analysis of the tax provisions in the American Recovery and Reinvestment Act of 2009*
- *A Climate for Change? Understanding the tax implications of U.S. greenhouse gas regulation*

Looking ahead to 2010

It is the hope of Private Client Advisors that the information presented in *The essential tax and wealth planning guide for 2010 — A year-round resource for navigating change in today's economy* was both thought-provoking and illustrative of the areas where proactive planning may yet bear fruit — notwithstanding the uncertainty that currently surrounds the tax code as Congress considers major health care and climate control legislation. We know this kind of legislative change must be financed and, at the same time, we await some form of meaningful approach to estate taxation beneath the backdrop of the sunset of the 2001 Act. We look forward to the coming year and the challenges that lie ahead as major new legislation appears inevitable.

To find a member of the Private Client Advisors group who specializes in your area of interest, please contact us at PrivateClientAdvisors@deloitte.com. Learn more about our Private Client Advisors practice by visiting our website at www.deloitte.com/us/privateclientadvisors.



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