DEAN DORTON FORD PSC
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NEWSLETTER

WINTER 2010

Year End Tax Planning Tips

Planning at the end of this year is as difficult as we can recall it being, due to uncertainty about next year's tax rates. We know that next year's tax rates are scheduled to be higher for most of our clients, but we don't know whether Congress will act to extend the 2010 tax rates into 2011 in an effort to avoid impeding economic recovery. Considering the size of the U.S. budget deficits being incurred and the resulting growth in national debt, we also recognize the pressure building on higher income tax rates, absent the development of radical changes in our federal taxing systems.

In light of this, here are some planning matters that might impact you:

Accelerate taxable income into 2010? If available, you should consider doing this. Even if tax rate increases are postponed, you are unlikely to lose much, if any, by accelerating income, especially considering the current extraordinarily low time value of short-term money.

Accelerate deductions into 2010? Normally, we suggest that you consider accelerating payment of deductible expenses (e.g., charitable contributions) that you otherwise would pay early next year, but that may not be an effective strategy considering the possibility of higher tax rates in 2011.

Realize net capital gains in 2010? Capital gain rates, along with ordinary income rates, are scheduled to increase in 2011, so long-term gain recognition this year may be beneficial. Using similar reasoning, realizing capital losses to offset long-term gains already realized this year may not be as beneficial as these losses may be in offsetting future capital gains.

First-Year Depreciation. The cost of most business equipment and furniture must be capitalized and depreciated over five to seven years. However, a special tax break is available to most small businesses. The Section 179 deduction permits immediate write-offs for up to $500,000 of 2010 qualifying additions. If you haven't yet made 2010 equipment or furniture purchases up to this amount, consider accelerating next year's planned purchases into this year to fully utilize this provision. The item purchased, which may be new or used, must be "placed in service" by year end for the deduction to be available. These rules apply to tangible personal property, which in addition to equipment and furniture includes breeding or racing horses and breeding cattle. Note that there are limits on the availability of the Section 179 deduction, the applicability of which you should ascertain before acting. Chief among these are that the deduction is only available to the extent of net business income, and the deduction is phased out dollar-for-dollar when qualifying property additions exceed $2,000,000 in the year.

Late Breaking News . . .

As we are completing our drafting of this issue, Congress and the Executive Branch seem to have reached an unofficial compromise which would extend 2010 tax rates for two years; reduce employee Social Security taxes from 6.2% to 4.2% for 2011; for 2011 and 2012, cap the top estate tax rate at 35% with an exemption of $5 million per individual; extend a number of tax benefits that had expired for 2010 or would have expired for 2011; and provide enhanced immediate deductions for capital expenditures which otherwise would be depreciated over time. By the time you read this, the compromise provisions, or some version of them, may have been enacted.

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continued on page 2

Year End Tax Planning Tips
continued from page 1

To the extent Section 179 deductions are not available for capital expenditures, bonus depreciation may be. For qualifying capital expenditures, 50% of cost can be deducted in the year assets are placed in service, and normal first-year depreciation is allowed on the other 50%. Qualifying capital expenditures generally must have a cost recovery period of 20 years or less. In general, the business must acquire the property and place it in service during 2010, and the property's original use must have begun with the acquirer.

S-Corporation and Partnership Losses. If your S-Corporation will generate a tax loss this year, consider whether you have enough basis in the stock (or in loans you've made to the corporation) to take the full loss. If you don't, additional investments should be considered. Similar considerations can arise in some situations with partnerships expecting tax losses.

Self-Employed Retirement Plans. If you have self-employment income and don't have a retirement plan in place to shelter any of it, you may qualify to use a Self-Employed Retirement Plan. Even though the plan does not need to be funded until the due date for filing your income tax return, the plan must be established by year-end in order to deduct contributions for 2010. The prospect of higher future tax rates eroding some of the benefits of income deferral should be considered.

Charitable Contributions. Consider "prepaying" contributions you would have made next year. Always consider funding charitable gifts with appreciated marketable securities, resulting in gains being untaxed. You may also charge charitable contributions on your credit card; contributions posted to your account before year-end are deductible this year, even if you do not pay the charges until next year. Note that accelerating these deductions may not be beneficial if tax rates increase in 2011.

Annual Gifting. You may give your children and others up to $13,000 in 2010 without any gift tax consequences. This annual exclusion is a per donee amount, and any unused exclusion does not carry over. Consider making year-end gifts to fully utilize the annual exclusion, and consider making your 2011 annual exclusion gifts early next year. The exclusion remains $13,000 for 2011.

Required Minimum Distributions. Rules for making required minimum distributions from IRAs and qualified retirement plans were suspended for 2009, but are effective again for 2010. Steep penalties apply to noncompliance, and not all IRA custodians or plan sponsors actively communicate the applicability of the rules to account holders and plan participants.

Roth IRA Conversions. We have discussed the rules and important considerations involved in converting traditional IRAs into Roth IRAs in earlier 2010 newsletters. The ability to convert extends beyond 2010, but only 2010 conversions can spread the resulting taxable income over 2011 and 2012. The advisability of taking advantage of this tax deferral must take into consideration the prospect of higher tax rates in either or both of 2011 and 2012. Deferring the conversion beyond 2010 risks a higher tax cost, if tax rates increase.

C-Corporation Dividends. For 2010, as has been the case for the last few years, most C-Corporation dividends have been subject to a 15% top federal tax rate. As now written, federal tax law would eliminate this favorable rate on dividends, which then may be taxed at as high a federal rate as 39.6% for 2011. Whether or not Congress acts to retain a favorable tax rate on dividends, a greater than 15% rate in the not too distant future is more than a remote prospect. Closely-held C-Corporations should consider paying dividends before the end of this year.

The Estate Tax Problem Revisited

As we discussed in our Spring 2010 newsletter, way back in 2001 Congress enacted a one year estate tax repeal for estates of individuals dying in 2010. Commentators had fully expected Congress to reinstate the estate tax for 2010, but that has not happened. So, it appears that the estates of individuals dying in 2010 will not be subject to estate tax. That's good news for the heirs of some very wealthy people who have died in 2010.

An offsetting cost to the no estate tax benefit for heirs of wealthier individuals dying in 2010 is a limit on the "step-up" to date of death market value in determining the income tax basis of inherited assets. Heirs of individuals dying in 2010 receive an income tax basis step-up of $1.3 million for assets transferred to any heirs and an additional $3 million for assets transferred to a surviving spouse. Executors of estates with values exceeding $1.3 million will need to file Form 8939 (not yet released) with the decedent's final (2010) personal income tax return to allocate this step-up among individual assets. Capital gains on the eventual sale of inherited assets that didn't get fully stepped-up basis to fair market value will be larger than they would have been under pre-2010 law.

For 2011, we continue to face significant uncertainty. As the law now exists, the estate tax will return to 2001 levels. The exemption will be $1 million (vs. $3.5 million for 2009), and the top tax rate will return to 55% (from 45% in 2009). Most commentators anticipate that Congress will act to modify this large tax increase, but as we learned in 2010, Congress doesn't always do what we expect.

In anticipation of the scheduled tax hike, some individuals with sizeable estates are considering making significant taxable gifts, including outright gifts to grandchildren, before year end, while the gift tax rate is 35% and the generation-skipping transfer tax is temporarily repealed. Additionally, with some members of Congress proposing restrictions on the use of some popular transfer tax planning techniques such as GRATs and family limited partnerships, some individuals are putting these tools in place before year end. The current low interest rate environment is causing many individuals to consider establishing GRATs and charitable lead trusts. Others are waiting to see what Congress does or does not do.

Uncertainty leads to opportunities, as well as to frustrations. Please contact us if you would like to discuss these items.

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Tips and Reminders for 2010 W-2 & 1099 Form Preparers

As you know, certain 2010 payments by business organizations must be reported to employees and other payees and to the Internal Revenue Service in early 2011. Form W-2s for employees must be sent to employees by January 31, 2011, and Form W-3, along with W-2 copies, must be filed with the IRS by February 28, 2011. If you are submitting 250 or more Form W-2s to the IRS, they must be filed electronically.

> **Tip: Special S-Corporation Rule.** Health insurance premiums and other fringe benefits paid by S-Corporations on behalf of greater than 2% shareholder-employees (including certain family members) must be reported as wages for income tax purposes on the shareholder-employees' Form W-2s. These benefits are not subject to Social Security or Medicare (FICA) or to unemployment taxes. The additional compensation is included in Box 1 (Wages) of Form W-2, but not in Boxes 3 and 5 of the form.

Form 1099s must be sent to payees by January 31, 2011, and copies, along with Form 1096, must be filed with the IRS by February 28, 2011. Form 1099-MISC must be filed, in general, for annual payments of at least $600 in rents or for services, where the payee is other than a corporation. However, you are required to report payments for legal services, even when the payee is a corporation.

> **Tip: Advance Matching Capability**. Many companies receive IRS notices regarding 1099 forms stating that the payee name and taxpayer identification number on the forms provided do not match the IRS's records. The IRS, through its e-Services web-based program, allows tax professionals and payers that register to use the service the ability to utilize a matching tool. This capability can help users identify information inconsistencies or errors before 1099 forms are issued.

If you have questions about these items, please contact us.

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How Concerned Should You Be About Identity Theft?

All of us are at risk of having our identities stolen. Identity theft occurs when someone uses another person's identifying information (e.g., name, Social Security number, credit card number) to commit fraud or other crimes. The Federal Trade Commission estimates that as many as nine million Americans have their identities stolen each year.

Thieves can steal your identity in a number of ways. Some examples are:

- "Dumpster diving"- someone steals from your trash to find personal information on discarded paperwork (e.g., credit card statements).
- "Skimming" - a person working in a retail establishment uses a special storage device to record your credit card information.
- Internet – Emails from what appear to be but are not reputable financial or other institutions which ask you to enter personal information so they can verify your identity.

Someone who has stolen your identity conceivably can open credit cards, rent property and have utilities set up, obtain a driver's license, open bank accounts, take out a loan, or even get a new job. All of these things can cause you serious damage.

How should you protect yourself from identity theft? Here are a few recommendations:

- Shred all personal information before discarding it.
- Never include personal information in emails.
- Password-protect your computers and cellular phones.
- Have spam filters in your email accounts to try to automatically segregate potentially threatening emails.
- Never open attachments or click on links in emails from senders you do not recognize.
- Note that your bank will NEVER send you an email asking for personal information.
- Never click on any pop-up in your Internet browser. Most browsers have settings to help reduce the number of pop-ups. Also, to close these pop-ups, always use the "x" in the upper right hand corner instead of clicking a button that says "close." The "close" button could redirect to a harmful website.
- Periodically scan your computer for viruses and spyware.

You also should take steps to detect identity theft. Periodically obtain a copy of your credit report from all major credit reporting agencies (TransUnion, Experian, and Equifax). They each provide one free credit report each year. You should review these reports to determine if any unauthorized credit facilities opened or closed during the year. Be alert, though, to read the information from these credit reporting agencies carefully so you do not unintentionally sign-up for more extensive monitoring services for which they charge.

To prevent someone from authorizing new credit using your identity, credit reporting agencies have an identity theft protection service (fee required), which may include these features:

- Daily Internet scanning for unauthorized use of your Social Security Number and debit or credit cards.
- Daily monitoring of your credit reports from the three major credit reporting agencies.
- National Change of Address monitoring that alerts you if someone changes your address.

Please be mindful that identity theft is a real threat. Do not be careless with your personal information, and take steps to prevent and detect any misuse of personal information.

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Some Tax Rates and Amounts for 2011

FICA Base - Annual compensation to which Social Security applies remains $106,800 for 2011. The Medicare tax continues to apply to all compensation.

Social Security Benefits - Individuals who are drawing Social Security benefits prior to attaining full retirement age will begin to suffer reductions in payments if they have earned income exceeding $14,160 in 2011, the same amount that applied in 2010.

Adjustments for Retirement Accounts - The maximum annual addition to a defined contribution plan remains $49,000 for 2011. The maximum amounts that individuals can elect to contribute to employer-sponsored plans and IRAs remain the same for 2011, as shown below, as do the "catch-up" contributions for individuals who are age 50 or older by the end of the tax year.

Year	IRAs		SIMPLE Plans		Other Employer Plans	
	Annual Contribution	Catch-Up Contribution	Elective Deferral	Catch-Up Contribution	Elective Deferral	Catch-Up Contribution
2011 and 2010	$5,000	$1,000	$11,500	$2,500	$16,500	$5,500

The maximum amount of compensation that can be considered as the base for retirement plan contributions remains $245,000 for 2011.

Standard Automobile Mileage Rates – The standard rates per mile for deducting automobile expenses are adjusted as follows:

	2010	**2011**
Business	$.50	$.51
Charity work	.14	.14
Medical	.165	.19

Section 179 Deduction – The maximum Section 179 deduction for 2010 and 2011 is $500,000, subject to a dollar-for-dollar phase-out range of $2,000,000 to $2,500,0000 of qualifying property purchases in each year.

Estate Tax – As we write this, the maximum federal estate and gift tax rate for 2011 is 55% (with a 60% marginal rate applying to net taxable estates between $10 million and $17.84 million). These transfer taxes will apply to cumulative taxable transfers exceeding $1,000,000.

Gift Taxes - The annual exclusion for gifts per donee remains $13,000 for 2011. The amount of taxable gifts above which gift taxes will be payable remains $1,000,000 for 2011.

New IRS Rules Expand Mandatory Use of Electronic Payment System

The IRS has issued regulations requiring the use of the Electronic Federal Tax Payment System (EFTPS) and discontinuing the use of paper coupons for almost all federal tax deposits. The new regulations will be effective for payments made after December 31, 2010. The penalty for non-compliance is 10% of the tax due. This change will require the following tax payments to be made electronically:

- Corporation income and estimated taxes
- Trust income and estimated taxes
- Unrelated business income taxes of tax-exempt organizations
- Private foundation excise taxes
- Taxes withheld on payments to non-U.S. persons
- FICA taxes and withheld income taxes
- Nonpayroll taxes, including backup withholding
- Federal unemployment taxes (FUTA)
- Excise taxes reported on Form 720

The proposed regulations provide an exception to using EFTPS for small businesses with less than $2,500 of tax liability per quarter. Businesses that qualify under this exception will be allowed to remit their taxes with their quarterly or annual returns.

The IRS has already begun to send instructions on how to activate your EFTPS enrollment through www.eftps.gov or by phone. Please contact us if you have questions about or need assistance with this issue.

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People News

We welcome **Tollie Miller** as our firm's Director of Human Resources. Tollie has considerable experience in HR organizational development, most recently working with Papa John's International, Inc. from its corporate headquarters in Louisville for 10 years. During her tenure there, Tollie worked in the areas of recruiting and in leadership, organizational, and talent development.

We also welcome **Charles "CJ" Smith** to our firm. CJ is working with our group providing technology services to clients.

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Mark Carter has been appointed Interim Chief Executive Officer of Passport Health Plan, based in Louisville. Mark will be leading the organization through a period during which, in addition to carrying out its ongoing mission, it works on a plan of correction mandated by the Kentucky Cabinet for Health and Family Services. The intended duration of Mark's appointment is three months.

Morgan Daulton has been elected to the Susan G. Komen For The Cure, Lexington Board of Directors, on which she serves as Treasurer.

Adam Shewmaker is participating in the Health Enterprises Network Fellows program.

Jeff Presser is serving as Editor of the Financial Scene in Health Financial Management Association's newsletter.

Hunter Stout has been awarded his CPA license.

Dean Dorton Ford received a Golden Apple Award, which recognizes "High Performance Partnerships" between Fayette County Public Schools and the community for our firm's and staff's contribution to the kids and their families at Breckinridge Elementary School.

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