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A tax, business, and financial planning newsletter for our clients and friends

What to Do Now to Save Taxes in 2010

If you want to keep your 2010 taxes as low as possible, the best way to do it is to develop a tax plan early in the year. Here's how to do it.

Establish your 2010 recordkeeping system now. If you fill out your 2009 tax return as soon as possible, you'll quickly see areas where you failed to keep adequate records to substantiate your deductions. By improving your record-keeping system, you can satisfy your current needs so you'll be certain to get every deduction you deserve in 2010.

Seek alternatives to personal interest loans. Personal interest is no longer deductible. The deduction for interest paid by individuals for personal use was eliminated years ago. However, the interest you pay on a home equity mortgage on your principal residence is still 100% deductible (within limits).

Review your tax returns for the past three years to uncover tax planning moves that will cut your overall tax bill. Line by line, look for items that have changed and made a difference in your taxes. Watch for those items in the future.

Re-examine your rental real estate investments. If your Adjusted Gross



Income is \$100,000 or less, you can deduct up to \$25,000 for rental real estate losses you might incur. But if your Adjusted Gross Income is \$100,001 to \$150,000, the \$25,000 limitation on losses is gradually phased out. Reevaluate whether you should keep your rental real estate investments if you can't deduct losses.

Contribute as much as you can to your company's 401(k) plan. Taxes on the amount you contribute and on the plan earnings are deferred until you withdraw the money. Begin mak-

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CLIENT'S tax & financial UPDATE

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taxPOINTS

Loophole: Analyze a mutual fund's capital gains exposure before you buy shares. While funds must distribute their dividends and interest to their shareholders every year, nothing prevents them from building up long-term gains in their portfolios. So two funds that look identical may produce very different after-tax returns when they sell the shares they own.

Example: Because of appreciation, a fund's value may include as much as 50% of capital gains appreciation. If a fund manager sold stock, shareholders would receive their proportionate share of long-term capital gains. Another fund's value might comprise only 10% of unrealized capital gains, and the tax bite to shareholders would be much lower. Call the fund or look for the capital gains exposure in analyses prepared by Morningstar or other fund data providers.

Loophole: Consider using family limited partnerships for gifts of closely held stock. You can make gifts of closely held shares to a family limited partnership, retaining the general partnership interest and giving children the limited partnership units over time. The general partner has complete control over the partnership.

Tax impact: Gifts of family limited partnership units can be discounted – that is, reduced in value – to take into account minority interests and lack of control and marketability. This reduces the gift tax owed on the interests. Gifts of family limited partnership interests also remove future appreciation in shares transferred from the estate of the original owner.

Your Financial Health: Time for an Annual Checkup

Now is an ideal time to review your financial plan for 2010. You now have the past year history of where your money is going, how your investments are performing, and what your savings are earning. By taking a look at where you stand now, you can adjust your financial strategies to better meet your goals by year-end. Here are the critical items to review.



Analyze your cash flow. Add up the income you received from all sources for last year: wages, interest, dividends, etc. Then add up all your expenses for the same period. If your income is greater than your expenses, make a plan to invest as much of the surplus as possible over the balance of this year. If your expenses are greater than you thought they'd be, adjust your discretionary spending habits accordingly.

Review your interest earnings. If you've got money parked in a pass-book savings account, you need to find alternative sources that offer a much better rate that are safe. When

you compare interest rates, be sure to consider the impact of compounding – it can make a real difference in what you earn.

Contribute to your IRA now. Whether or not you are eligible to deduct your IRA contribution, make a contribution now because income earned in an IRA is tax-deferred. Don't pay taxes on interest you earn when you can defer the tax until you retire.

Adjust your withholding. Many people deliberately have excess withholding taxes deducted from their paychecks. It makes no sense to pay money to Uncle Sam that could be earning interest for you. And because many states have increased their income tax rate, you may be giving up even more money than you think.

Review your disability insurance. The most common mistake in personal financial planning is failing to have adequate disability insurance coverage. From an actuarial standpoint, it's more likely that you'll become temporarily disabled than it is that you'll die during your income-earning years. A good rule of thumb is to have coverage that will pay you about two-thirds of your pre-tax earnings. Look for a policy that will protect you until age 65.

Re-examine your will. Has your personal or financial situation changed during the past year? If so, you should look at your will for possible updating.

Miscellaneous Deductions: Fully Deductible or Not?

Miscellaneous deductions are those deductible items which are not medical expenses, taxes, interest, charitable contributions, or casualty losses. Miscellaneous deductions fall into two groups. Some are fully deductible and some are deductible only to the extent that they exceed more than 2% of a taxpayer's Adjusted Gross Income (AGI).



Fully deductible

- Estate taxes which have already been imposed on the same taxable income
- Employment-related moving expenses
- Job-related expenses of handicapped persons such as personal aides, etc.

- Gambling losses, but only up to the amount of winnings
- Money previously included in income, but which you have since repaid

Subject to the 2% floor

- IRA or Keogh custodian fees
- The cost of a safe-deposit box
- Investment expenses
- Tax preparation costs
- Employee business expenses such as 50% of meals and entertainment, travel, supplies, business books and magazines, and home-office deductions
- Depreciation on automobiles, tools, and other equipment purchased for business use
- Education expenses that are job-related
- Hobby expenses up to the amount of income derived from the activity
- Professional or union membership dues

Savings Bonds: Best Left to Charity

If you plan to make a charitable bequest through your will, consider funding it with US savings bonds that you own instead of cash.

Why: Series EE and I bonds appreciate in value rather than pay cash interest.

But after their owner's death, previously untaxed appreciation in the value of both Series EE and I bonds and Series HH bonds (for which EE bonds may be exchanged on a tax-deferred basis to obtain a source of interest income) will

be ordinary income taxed at top rates to the heirs who inherit the bonds.

Better: Leave cash to heirs and savings bonds to charity, instead of the reverse.

Neither will owe tax on what you leave them, and you will disinherit the IRS.



Charitable Giving

Saving taxes is rarely the main motivation for making charitable contributions. Most people give out of a desire to benefit humankind, not to save taxes.

However, the tax savings generated by charitable contributions enables donors to give away more than they might otherwise have thought possible. Examples...

- A donor in the 35% tax bracket who planned to give \$10,000 cash, can actually give \$15,385 and be out-of-pocket only \$10,000 after factoring in the tax savings from the deduction.
- A donor in the 35% tax bracket who gives long-term stock worth \$10,000 that has appreciated from \$5,000, is really giving only \$5,750 out-of-pocket. He's saving \$4,250 in taxes.

There is a \$3,500 tax savings from the donation (\$10,000 x 35%), plus a capital gains tax avoidance of \$750 (15% of the \$5,000 of appreciation).



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ing 401(k) contributions as soon as you can to maximize your tax deferred earnings.

There's another advantage to 401(k) plans, because your federal withholding tax is based on your salary minus your 401(k) contributions. For example, if you earn \$100,000 a year and contribute \$8,000 to a 401(k) plan, your withholding tax is based on a salary of \$92,000, so less taxes are withheld from your paycheck.

Start a Keogh plan now. Any individual who has self-employment income from a business, from freelancing, or from a sideline activity can establish a Keogh plan. You can contribute a siz-

able portion of self-employment income to a Keogh plan and defer taxes on both the contribution and its earnings until you actually withdraw the money. Make your Keogh contributions early in the year so you can begin to earn tax-deferred income as soon as possible.

Review employee benefits. Does your company offer a range of benefits under a "cafeteria" plan? If you have young children, you may need employer-paid dependent care. If you are over age 50, you may prefer long-term care insurance.

When both spouses work and have benefits, it's important to coordinate the selections so that the family gets the strongest benefit package

Example: The spouse with the better

medical coverage should choose that benefit for the family, while the other spouse might opt for increased disability coverage from his/her plan.

Choose investments that let you defer interest until 2011. You won't be taxed on that income until you file your return in April of 2012. One such possible investment is U.S. Treasury Bills which have a maturity date in 2011. Another is certificates of deposit that are due in 2011. Be sure, however, that the CD maturity date is one year or less because if the CD matures after one year, you'll have to pay taxes on the interest as it accrues rather than when the CD matures.

How Long to Keep Old Tax Records

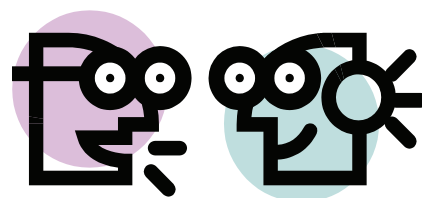
The IRS says taxpayers must keep old tax returns and other tax records for as long as they may be needed for the administration of any provision of the Tax

Code. Generally, this means you must keep records that support the items shown on your return until the statute of limitations for that return runs out.

MAJOR TIME LIMITATION PERIODS	
Normal audit limit	3 years
Audit limit if gross income is understated by 25% or more	6 years
Time limit for deducting worthless securities/bad debts	7 years
Audit limit if no return is filed	no limit
Audit limit if fraud is committed	no limit

Important: All tax records for properties such as homes, businesses, and investments should be held until you dispose of them and report the disposition on your tax return, in addition to the time limits above. **Trap:** The IRS can always create a situation in which

it says no time limit applies to your return by alleging that you never filed or that you committed fraud on your return. You'll need copies of your return to refute such an allegation—so the safest practice is to keep your returns forever.



Smarter Business Thinking

Delegation danger

It's a big mistake to delegate only the tasks you don't like to do. It's bad for employee morale, and you get yourself into poor management habits. Instead, delegate interesting duties as well. That makes employees' jobs more interesting and improves staff moral.

And if you use the time you save to take on more important tasks, you'll find your own job will become more gratifying.

Shrewd negotiating trick

Silence is often golden. Sometimes the best response to an offer is to say nothing. When you don't react, the other party frequently takes your silence as a negative response and will make a better offer.