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Tax Planning Letter

MIDYEAR 2009

Dear Clients and Friends,

Job losses, stressed banks, market volatility, massive federal debt. The news at midyear 2009 is filled with ongoing financial struggles for individuals and institutions. Washington is trying to get the country back on track and, at the same time, take on the triple challenges of health care, energy, and education.

A stimulus bill was signed into law in February 2009, with tax changes that could affect you and your business. Congress has plans to craft additional tax legislation this year, including making the estate tax permanent rather than allowing it to expire for one year in 2010.

This newsletter is being sent to you to encourage you to do a midyear tax review of your own situation. The tax law changes so frequently that only constant attention to the pitfalls and opportunities in the rules will enable you to keep your taxes under control. Not every suggestion in this newsletter will be appropriate for you, and other options not mentioned may be more suitable in your particular situation. To make your 2009 tax-cutting efforts most effective, call now and let's get together for a midyear tax planning review.

Sincerely,

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Squeeze some tax savings from your midyear planning

Frugality is the watchword this summer, making midyear tax planning more relevant than ever. Here are three situations that offer opportunities for tax thriftiness.



Heading to college

With fall semester coming up fast, now's the time to plan to maximize the tax benefits of dependency exemptions, education tax deductions and credits, and college savings plans.

For example, the general rule is that you can claim your under-age-24, full-time college student as a dependent as long as you pay more than half the cost of necessities such as food, clothing, and shelter. However, your situation may warrant giving up the exemption.

Why? Here's one reason: For 2009 and 2010, the Hope scholarship credit has been replaced with the American opportunity credit, which can be partially refundable. Depending on your income – and your child's – you could potentially get more overall tax benefit from this and certain other education credits by forgoing the dependency

exemption on your federal income tax return. Run the numbers now to give yourself time to coordinate a program of family tax savings.

You may also want to review your 529 college plan so investment changes can be finalized before school starts. You can update your investment strategy twice during 2009 (in addition to any revisions you make when changing a beneficiary) without jeopardizing your plan's tax-deferred status.

Have the assets in your 529 plan declined in value to the point where they are worth less than your basis? Liquidating the balance may generate a miscellaneous itemized deduction on your 2009 federal income tax return.

After you close the account, you can deposit the proceeds into a new 529 plan, but you may have to wait 60 days before reinvesting in order to claim the deduction.



Work-related transitions

If you're thinking of taking on a second job this summer, reviewing your withholding is a wise planning move. That's because the recently enacted "making work pay" credit reduced the income tax deducted from your wages.



Tax changes for 2009 present opportunities that you should consider as you assess your situation at midyear. Here's a quick review of the tax breaks for you and your business. Income limits and various restrictions apply to many of them.

- Making work pay credit of up to \$400 for singles and \$800 for couples.
- First-time homebuyer credit of up to \$8,000 for homes purchased before December 1, 2009.

- Above-the-line deduction for taxes paid on the first \$49,500 of the purchase price for a new vehicle.
- Alternative minimum tax exemption for 2009 raised to \$46,700 for singles, \$70,950 for couples.
- Increased credits for energy-saving home improvements.
- Credit for college costs increased to \$2,500 and applicable to four years of education.

The maximum credit is \$400 if you're single (\$800 if you're married filing jointly), but the amount phases out once your income reaches \$75,000 (\$150,000 if you're married filing jointly). Remember, too, that the credit is offset by the \$250 economic recovery payment you received if you collect social security or certain other government benefits. Estimating how much you're entitled to can help prevent tax underpayments and associated penalties.

You may also want to check the impact of the making work pay credit on your college-age kids if you're claiming them as dependents and they're holding down a job. Dependents are not eligible for the credit.

Switching to a new employer requires retirement plan contribution planning that you might not have considered. As an example, for 2009 your annual 401(k) contributions are limited to a total of \$16,500 (\$22,000 if you're over age 50). That figure includes contributions you make to all your employers' plans.

Calculate and adjust retirement plan contributions when you change jobs, as excess amounts could lead to unexpected additional taxes and penalties.

Are you making the leap to self-employment this summer? You might have to begin paying estimated taxes – a development you will probably want time to budget for. Under new rules for 2009, you'll generally have to pay in at least 90% of the federal income tax you owed for 2008 in

order to avoid penalties.

What if you're between jobs? For 2009, you can collect up to \$2,400 of unemployment benefits tax-free. Amounts above \$2,400 are included in your income – but withholding is typically voluntary. Taking this change into consideration when estimating your annual income can help you decide if you should elect to have tax withheld from your benefits.



Checking retirement accounts

For 2009, withdrawals from your IRA, 401(k), and certain other retirement plans are voluntary when you're over age 70½. Lower withdrawals translate into lower taxable income, so choosing to forgo the rest of this year's distributions could reduce your income tax.

Not sure about giving up a distribution because you need the supplemental inflow? Evaluate your retirement savings to determine if taking money from other accounts will result in a tax benefit at year-end. For instance, deciding to cash

a low-interest certificate of deposit provides cash without significantly increasing taxable income. Employing this tactic instead of taking a retirement plan distribution may also decrease the taxable amount of your social security benefits, which in turn could put you in a lower tax bracket.

Now is also a good time to consider converting a traditional IRA to a Roth IRA, assuming you're not subject to the \$100,000 adjusted gross income limitation. You have to pay income tax on the amount converted. But if the assets in your IRA have declined in value, the tax could be lower now than if you wait for the assets to recover.

As you run through the calculations, keep in mind that under present law, deciding to delay the conversion to a Roth until 2010 will give you the option of paying the tax due over two years. In addition, conversions will be available next year regardless of adjusted gross income.

What if you already converted to a Roth IRA prior to a loss in the account's value? By putting the account back into a traditional IRA via a trustee-to-trustee transfer, you can reverse, or "recharacterize," the transaction. For tax purposes, a recharacterization has the same effect as if the original conversion never happened.

Other prudent summertime planning moves include assessing your exposure to the alternative minimum tax as well as state and local income taxes. Please call to schedule a midyear financial checkup. Our goal is to help you manage your financial situation in the most tax-frugal manner possible. ■

Estimating how much credit you're entitled to can help prevent tax underpayments and associated penalties.

- COBRA subsidy for health insurance premiums for those who lost their jobs.
- First-year 50% bonus depreciation for new business equipment purchased in 2009.
- First-year expensing allowed at \$250,000 limit for the purchase of new and used business equipment.
- Carryback of 2008 net operating losses allowed for up to five years for qualifying businesses.
- Various energy tax breaks enhanced for businesses.
- COBRA subsidy paid by employers is reimbursed through payroll tax adjustments. ■

Steer a course to lower taxes

Savvy business owners know that in a turbulent economic climate, operating efficiently is critical for success. An important, yet sometimes overlooked step toward that goal is a midyear review of your tax situation. And with the latest round of tax law changes passed by Congress, a thorough tax review has never been more critical.

■ The basics

First of all, check to see if your estimated tax payments are in line with current-year income projections. Assumptions you made going into 2009 may no longer be valid. Lower sales or higher expenses might mean a reduction in your quarterly tax estimates.

Now is a good time to review your recordkeeping methods too.

Proper substantiation is required to claim vehicle mileage deductions, business use of personal property, and other write-offs. Without these records, important tax savings may be lost to you.

Businesses can also help save taxes by examining their receivables and inventory levels. Accounts receivable that are no longer collectible and inventory that has become obsolete may provide an important deduction. Consider donating slow-selling inventory to charity.

■ New equipment tax perks

The *American Recovery and Reinvestment Act of 2009*, passed in February, provides important new incentives for business investment. For 2009, the Section 179 write-off of qualified equipment purchases (new or used) has been increased again to \$250,000. This deduction is gradually reduced once annual equipment acquisitions exceed \$800,000.

In addition to the Section 179 deduction, brand new equipment, software, and qualified leasehold improvements can further qualify for 50% first-year depreciation if placed in service by the end of 2009. This provision was originally set to expire at the end of last year. Certain assets with a longer useful life can be placed in service as late as December 31, 2010, but still must be purchased before the end of 2009. New autos and light trucks acquired for business use might qualify for an additional \$8,000 in depreciation if purchased and placed in service this year.

■ Recoup former taxes

The *Recovery Act* extended the 2008 net operating loss carry-back period from two years to as many as five years, providing an opportunity to recover taxes paid before the recent business downturn. To be eligible, your average annual gross receipts for the last three years must be \$15 million or less. This tax rule is valid only for 2008, but fiscal-year taxpayers have the added flexibility of applying the carryback to tax years beginning or ending in 2008.

■ Laws affecting your employees

Some aspects of the *Recovery Act* may affect your employees. Eligible former employees who request continued health insurance coverage through the familiar COBRA provision are now required to pay only 35% of the monthly premium. The employer pays the remaining 65%, but can claim a tax credit for this amount on the company's payroll tax returns. The net effect to the employer, therefore, is a wash. However, certain documentation must be maintained to claim the credit. This includes proof of the former employee's payment of his or her share, a copy of the paid insurance plan invoice, and a statement declaring that the employee was involuntarily terminated.

Your employees who commute to work might be interested in the new transportation tax breaks. Employers can now provide workers with tax-free reimbursements of up to \$230 per month for qualified mass transit and van pooling expenses. In addition, employees may be reimbursed up to \$230 per month for parking fees related to mass transit or van pooling, resulting in a maximum monthly benefit of \$460.

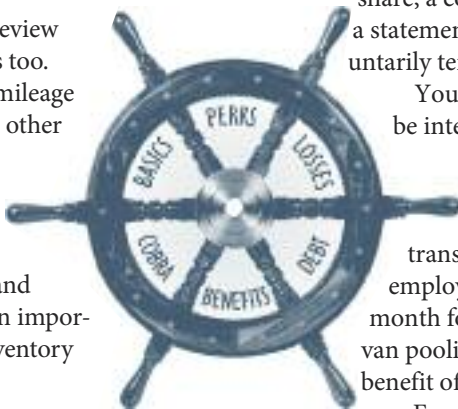
Employees who ride their bikes to work can receive a tax-free benefit of up to \$20 per month for their out-of-pocket cycling costs.

■ Debt discharge benefit

Businesses that reacquire their own debt in a restructuring move must normally treat as income the net reduction in indebtedness. But the new law allows qualified debt discharge income received in 2009 and 2010 to be deferred and then taxed over several future years.

■ Choppy waters

Turbulent economic conditions, coupled with an ever-shifting tax environment, make for a perfect storm of challenges to your business. To help you navigate through it, give our office a call today. ■



Assumptions you made going into 2009 may no longer be valid.