Money & Investing

The Two-Year Tax Plan

With future tax rates and breaks uncertain, it's time to focus on a two-year plan.

By Ashlea Ebeling

What does the future hold for the federal income tax? Will we

get lower rates but fewer deductions and credits, as reformers favor? Or will higher rates be piled atop the current messy tax code? We don't know. But we do know some smart moves you can make now to capitalize on temporary tax breaks that expire at the end of 2011 or 2012 and to hedge your bets against the uncertainty.

Grab Expiring Tax Breaks

These come in two varieties. Some are special giveaways adopted to juice the economy and are unlikely to be renewed. Others are on a growing list of breaks that have gotten extended repeatedly but aren't assured renewal, considering the deficit.

Write Off a Cadillac Escalade

Last December's bipartisan tax deal included a temporary 100% write-off (known as 100% bonus depreciation) for new equipment placed in service by Dec. 31, 2011. This break, which is unlikely to be extended, isn't just for big companies.

"It could be significant savings for the little guy, too," says **Howard Krant, a New York City CPA and partner at Adeptus Partners, LLC.** He notes that 100% bonus depreciation can be more valuable than another, longer-standing 100% write-off provision (known as Section 179) available to small businesses.

That's because you can't use Section 179 to claim a loss. But if you're actively involved in running a business, you can not only claim losses generated by 100% bonus depreciation against other income but can also carry any still unused losses back for three years and get a big refund check from Uncle Sam.

One **ADEPTUS PARTNERS** client, a real estate professional, is installing $250,000 of new appliances in an apartment complex he owns and using the write-off to offset rental and other income on his 2011 return.

There's another advantage to bonus depreciation. Back in 2004 Congress decided Section 179 can't be used to write off a vehicle costing more than $25,000. But bonus depreciation can be used for a new vehicle weighing more than 6,000 pounds, no matter the price. So there's a short open season to write off the cost of a new $70,000 Cadillac Escalade – if it's used only for business.

Grant a Conservation Easement

With a conservation easement, you agree not to develop your land and you get a deduction for lost value. An ordinary taxpayer who grants an easement in 2011 can use the deduction to offset up to 50% of his adjusted gross income, instead of the usual 30%. Farmers and ranchers who act this year can offset 100% of income. Plus, deductions for 2011 easements can be taken over 16 years, until used up. Normally, only 6 years is allowed.

Who is a farmer? For this tax break, anyone who gets more than half of his gross income from farming this year. That means a gentleman farmer who receives little or no income from his corporate business in 2011 could donate an easement and might be eligible to offset 100% of his taxable income from both farm and nonfarm activities for years to come. (Get expert advice, since "gross income" is calculated a special way for this break, cautions Stephen J. Small, a Newton, Mass. lawyer who arranges easements.)

Give to Charity From Your IRA
Also expiring at the end of 2011 is a provision that allows taxpayers 701/2 or older to transfer up to $100,000 a year directly from their traditional pretax individual retirement accounts to charity--without counting the transfer in their income. No, you can't double dip and claim a charitable deduction for the transferred money. But a direct transfer (called a charitable rollover) might result in a lower tax bill than recognizing an IRA withdrawal as income and then claiming a charitable deduction.

Plus, you can count the rollover against the annual minimum distributions those 701/2 and up must take from traditional IRAs. That helps hold down gross income, potentially sparing a senior from the hefty extra Medicare premiums charged to higher-income folks.

Hedge Against Higher Rates
Under current law, if a gridlocked Congress does nothing, in 2013 the top rate on ordinary income will rise from 35% to 39.6%, while the rate on long-term capital gains will go from 15% to 20%.

Sell a Business
Even if some version of tax reform was to pass, the capital gains rate is unlikely to go lower, making 2011 or 2012 a good time to recognize big capital gains, say from the sale of a business.

Clients have a chance to save some real dollars by working through transactions this year and next year," says James Guarino, a CPA with MFA-Moody, Famiglietti & Andronico in Tewksbury, Mass.

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> **Adeptus Partners, LLC**

Milk the 0% Gains Rate
By definition the long-term gains rate for those whose top regular rate is 15% can't go any lower--it's now 0%. In 2011 the 0% bracket covers gross income up to $44,000 for a young single and $90,300 for a couple over 65, assuming taxpayers claim the standard deduction. This presents an opportunity for retired folks to recognize some tax-free gains and for middle-aged folks to give appreciated stock to their just-starting-out adult children, who can then sell it and pay no gains tax.

Remember, however, that the "kiddie tax" applies to full-time students up to age 24, which means their investment income above $1,900 is taxed at their parents' higher rate.

Plan for Fewer Deductions
Tax reform could limit how much new money you can put in tax-advantaged retirement accounts, so stuff them now. The trickier issue is whether to grab a deduction now by contributing funds to pretax accounts (sensible if you'll be paying at a lower rate when you retire) or to fund after-tax Roth accounts (wise if you'll be paying at the same or a higher rate in retirement).

Even if tax reform doesn't happen, deductions could also be limited in the name of deficit reduction.

For example, President Obama has proposed that itemized deductions – for mortgage interest, investment expenses, charitable giving, state and local taxes and the like – only be allowed to be claimed against a 28% rate, beginning in 2012.

"It's really an eye-opener that the world hasn't caught up with," says Robert Gordon, president of Twenty-First Securities. He points out that it would make not only big home mortgages but also leveraged investments such as hedge funds and stocks bought on margin less attractive, since investment interest would no longer be fully deductible.