Werba & Davis
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Tax Planning in the Midst of Uncertainty

It's the eleventh hour for year end tax planning, but there are still some options on the table that can help minimize your tax burden if not immediately, then over the next few years. With all of the uncertainty surrounding new tax legislation for 2011, and the present status of the Alternative Minimum Tax it's difficult to plan for the future. Nevertheless there are four immediate measures that should be considered between now and December 31, 2010.

1. Convert Traditional IRAs to Roth IRAs

Even if Congress were to extend the Bush tax cuts, taxes are likely to increase in the long term as health care reform kicks in. Medicare is practically insolvent, and a 3.8% tax on investment income is scheduled to begin in 2013 to help fund it.

Wouldn't it be nice to have a source of retirement income that will be tax free, regardless of future tax rates? A Roth IRA, rather than a traditional IRA, can provide that tax-free source.

Although funds invested in Roth IRAs are taxed up-front, they grow without being subject to additional taxation. Owners of Roth IRAs are not mandated to take required minimum distributions (RMDs), whereas traditional IRA holders must take RMDs starting at age 70½. Since income from Roth IRAs is not included in AGI for calculating federal income taxes, it can also be used in combination with distributions from other retirement accounts to lower the account holder's tax rate during retirement.

Until 2010, conversions were allowed only for taxpayers with adjusted gross income (AGI) of less than $100,000 a year. Now anyone can convert traditional IRAs to Roth IRAs.

There are two options with regard to recognition of Roth IRA conversion income:

1. Elect to recognize 100% of the fair market value on the date of conversion as income in 2010 and pay tax at the current tax rates, or
2. Taxpayers can convert in 2010 and defer the recognition of the income until 2011 (50%) and 2012 (50%).

When determining which option is best for you it is important to note that if income is deferred until 2011 and 2012, you will pay taxes based on the rates in effect at that time.

There are many other factors to consider in determining if a Roth conversion is right for you. However, consideration of a conversion should be part of everyone's year-end planning process.

2. Make Charitable Contributions

One strategy for dealing with that hefty tax bill (including the tax on a Roth IRA conversion) is to reduce the tax liability by making charitable contributions.

Contributions of securities or real property held long term that has appreciated in value can provide even better tax benefits. While the deduction is limited to 30% of AGI when donating to a public charity, you can receive a charitable deduction for the full fair market value of the assets, not just what you paid for them. You will also eliminate capital gains tax that would otherwise be due on a sale.

3. Gift Assets

The federal estate tax was eliminated for 2010, although heirs will not be able to take a step-up in basis for assets they inherit this year. Next year, if Congress takes no action, assets will be subject to a federal estate tax of up to 55%, with an exemption on just the first $1 million in assets.

Death is an unattractive alternative even when it provides a considerable tax benefit, but there are other ways to take advantage of this year's tax rates. One is to gift assets to heirs this year. Taxpayers can gift assets valued up to $13,000 ($26,000 for married couples) to as many people as they want annually without subjecting themselves to the gift tax. In addition, each taxpayer is allowed a lifetime gift exemption of $1 million.

You can also gift unlimited assets and pay the gift tax at the current rate, which is equal to the top federal income tax rate of 35%. Next year, if no action is taken, the gift tax rate will be the same as the estate tax rate, with a top rate of 55%.

Grandparents should also be aware that they can make gifts to grandchildren this year without paying a generation-skipping transfer (GST) tax. The GST tax is scheduled to return in 2011 at the same rate as the estate tax, but with a $1 million lifetime exemption. While gifts are exempt from the GST tax this year, gift tax rules still apply.

4. Maximize 2010 Income and Capital Gains

For many taxpayers, the long-term federal capital gains tax rate is scheduled to increase from 15% to 20% on January 1, 2011. Additionally, unless Congress acts, the top income tax rate is scheduled to increase from 35% to 39.6% — a 4.6% increase. Qualified dividends will be taxed as ordinary income, instead of at the 15% rate, so some taxpayers would pay nearly 40 cents (versus the current 15 cents) on a dollar of dividend income. Keep in mind, these increases may not take place if the Bush tax cuts are extended.

You can take advantage of current low rates by selling securities and other property that have appreciated in value before year end, by accelerating taxable income into this year and by delaying deductions whenever possible. Retired individuals may consider taking distributions in excess of the required minimum this year to take advantage of current rates.

Before implementing any of these strategies it is important to review the impact of each decision with a tax advisor. Werba & Davis can help you figure out what makes sense for your individual need, and advise you accordingly.

For further information please contact Aaron at (408) 260-3138.

Name Change on the Way!

As of January 1, 2011 Werba & Davis Advisory Services will be changing its name to Werba Rubin Wealth Management, LLC. New ADV forms explaining the change, and reiterating the services that we provide will be sent out in December. For now you can begin following us on Twitter. Our handle is: WRAdvisory. Look for updates and interesting articles relating to tax, retirement, estate planning, and more!