

# Uncertainties make 2010 an interesting year

This year promises to be one of great challenges for tax planning professionals and their clients. Tax planning involves arranging business and personal financial affairs in a manner to minimize the income and estate tax burden given the existing tax laws.

In 2010 we face many unique challenges. The income tax rules and rates for 2010 are set, but we can only speculate as to what they will be in 2011 and beyond. With respect to the estate tax, as of this writing, there is no estate tax in 2010. We certainly do not know what to expect after that.

Many speculate that the "Bush tax cuts" enacted in 2001 may simply be

allowed to expire. When these changes were enacted in 2001 there was a 10-year sunset provision on them. Thus, this year



**VIEWPOINT**  
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Congress, by doing nothing, can raise tax rates on a variety of taxes affecting a broad range of taxpayers. There has been substantial discussion and commentary about the desire to raise taxes only on higher income taxpayers, and the desire to have a higher estate tax exemption. However, making any of these changes will require congressional action. Soaring budget deficits suggest the

need to increase revenue and/or reduce expenditures, but expenditure reduction does not currently appear likely.

With this in mind, what strategy should a taxpayer consider for 2010? In general,

with the expectation of higher tax rates, a common strategy is to accelerate income into 2010 and defer deductions into 2011 where they may have a greater tax benefit. The effects of this strategy would be potentially mitigated or reduced if the tax benefit for certain itemized deductions might be further limited. This is not the law, but it has received significant press as a potential change that would increase revenue. Like most tax strategies, the right answer depends on each taxpayer's particular circumstance. Additionally, the alternative minimum tax makes planning even more challenging.

One widely anticipated potential change is an increase in the capital gains tax rate beginning in 2011. A taxpayer selling an asset with a large capital gain might choose to do so in 2010 rather than waiting until 2011. Strategies to defer capital gains taxation

by purchasing replacement property may become less advantageous with the likelihood that a future tax will be greater than the current tax.

There is substantial discussion about converting tax-deferred IRA accounts to Roth IRAs in 2010. This would result in current taxation, but from that point forward the IRA and its future growth would be tax-free. There is, however, the ability to spread this income between 2011 and 2012 rather than recognizing it in 2010. A Roth conversion may be a favorable strategy if you can pay the tax with other funds, don't need the IRA funds to live on, and ideally can pass the IRA to the next generation. Heirs will be able to take advantage of the long-term payout rules for an inherited IRA and accumulate and receive tax-free income. This presumes that in the future Congress doesn't change the rules in an effort to gain future revenue. Furthermore, the offer to spread the tax liability over the next two years sounds attractive, but it could result in higher total taxes if rates increase.

The right answer for individuals will be very much driven by their specific circumstances.

Fortunately, if the decision to convert turns out to be a bad idea, due to changed circumstances or because the converted IRA fell in value, the taxpayer has until the due date of their tax return in 2011 to undo the decision. If advisable, they can reverse the transaction, reconvert their Roth to a regular IRA and pay no tax.

Planning for the estate tax is even more problematic. Currently, under the law, there is no estate tax in 2010 (resulting in a loss of revenue for the federal budget). Few believe that this will remain the case. Congress apparently plans to retroactively reinstate the 2009 law and limits for 2010 and then "fix it" for 2011 and beyond. Unfortunately, the "we'll fix it next year" mantra has been used each of the last few years and we are running out of time. If Congress does nothing, estates above \$1 million become taxable instead of the 2009 level of \$3.5 million.

This uncertainty makes estate tax planning extremely difficult. Low values for many assets and low interest rates make many traditional techniques to reduce taxable estates more attractive than they have been in the past. However, discounting is only effective if the estate is ultimately taxable. For now, planners working with smaller estates are considering discount strategies that could be reversed in a future year if the tax law should change.

To summarize, 2010 will be challenging in many ways for planners and their clients. Changes in the tax law have become routine over the last 30 years, but rarely have there been so many uncertain issues that dramatically impact decisions. Additionally, we have a legislative process that often results in the final changes being decided on at the last minute, leaving little time for proactive planning. Add the potential for higher tax surcharges to help pay for health-care changes, higher Social Security taxes to fund growing obligations and possible increases in state taxes and it becomes important to plan for, and react to, changes as they are made in order to minimize your tax burden and accomplish your other financial goals.

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