



Suite 925
Fifth Third Center
600 Superior Avenue East
Cleveland OH 44114
Tel 216.373.2500
Fax 216.373.2501
www.lgkw.com

July, 2010

To Our Clients and Friends:

Although this year is half over, we've already seen legislation with major tax changes, and more are on the way. Despite confusion created by the never-ending changes, the 2010 federal income tax environment is still quite favorable. However, we may not be able to say that for 2011 and beyond. Therefore, tax planning actions taken between now and year-end may be more important than ever. This letter presents some planning ideas to consider this summer while you have time to think.

First, some thoughts about individual tax planning.....

Traditional Strategy of Deferring Income Is Dickey This Year

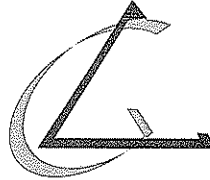
Be careful when considering the time-honored strategy of deferring taxable income from this year into next year. The strategy still makes sense if you're confident you'll be in the same or lower tax bracket next year, but the tax picture for 2011 is blurry.

The top two individual rates are widely expected to increase from the current 33% and 35% to 36% and 39.6%, respectively. Without additional legislation, the favorable 15% tax rate on qualified dividends will expire at the end of 2010 resulting in dividends being taxed at ordinary income tax rates. The picture becomes even bleaker in 2013 when Medicare provisions of the health care bills kick in. The Medicare tax rate will increase from 1.45% to 2.35%, self-employment tax will increase by .9% and a new 3.8% tax on "net investment income" will apply to individuals earning more than \$200,000 and families earning more than \$250,000. The new 3.8% tax will also apply to estates and trusts on the lesser of (1) undistributed "net investment income" or (2) all adjusted gross income in excess of \$11,200 (excluding charitable trusts). Therefore, individuals in the top two brackets might want to consider reversing the traditional strategy and accelerating income into 2010 to take advantage of this year's presumably lower rates.

We will send an update later this year when we have more clarity about what's going to happen with tax rates in 2011 and beyond.

Higher-income Individuals May Benefit from Accelerating Itemized Deductions into 2010

For 2010, the dreaded phase-out rule that previously reduced write-offs for the most popular itemized deduction items (including home mortgage interest, state and local taxes, and charitable donations) is gone. However, the phase-out rule is scheduled to come back with a vengeance in 2011 unless Congress takes action to prevent it, which now looks increasingly unlikely. If the phase-out rule comes back as expected, it will wipe out \$3 of affected itemized deductions for every \$100 of Adjusted Gross Income (AGI) above the applicable threshold. Individuals with very high AGI can see up to 80% of their affected deductions wiped out. For 2011, the AGI threshold will probably be around \$170,000, or around \$85,000 for married individuals who file separate returns.



Time Investment Gains and Losses and Consider Being Bold

As you evaluate investments held in your taxable brokerage firm accounts, consider the impact of selling appreciated securities this year instead of next year. The maximum federal income tax rate on long-term capital gains from 2010 sales is 15% but is scheduled to increase to 20% in 2011. To the extent you have capital losses from earlier this year or a capital loss carryover from pre-2010 years, gains from the sale of appreciated securities this year will be a tax-free deal because the losses will shelter your gains. This is especially favorable if you have short-term gains in your portfolio since they are taxed at your ordinary rate (which could be as high as 35%). However, it is important to remember that ordinary and capital gain tax rates will increase after 2010 so it may be more advantageous to hold on to capital losses to offset gains in 2011 when rates are higher. Some advance tax planning will be necessary to be sure you are taking advantage of the tax rate changes.

Convert a Traditional IRA into Roth IRA

Before this year, there were two big restrictions on the Roth IRA conversion privilege. First, your Modified Adjusted Gross Income (MAGI) could not exceed \$100,000. Second, you were completely ineligible if you used married filing separate status. For 2010, both restrictions are eliminated. This has created a great deal of discussion about how to most effectively structure and utilize your retirement plan assets. In some cases, the current tax hit from converting, while unwelcome, may be a small price to pay for future tax savings. (After the conversion, all the income and gains that accumulate in your Roth IRA, and all withdrawals, will be totally free of any federal taxes--assuming you meet the tax-free withdrawal rules. Roth IRAs are also not subject to the required minimum distribution rules.)

However, conversion is not a no-brainer. The calculation of the tax "benefits" of converting rely very heavily upon future tax rate, market performance, and account distribution assumptions that stretch many years into the future. You have to be satisfied that paying the upfront conversion tax bill makes sense in your circumstances. It also may be helpful to benchmark conversion calculations against alternative "investment" options such as the purchase of a single premium life insurance policy for an amount that would otherwise have been paid in taxes upon conversion.

If the Roth IRA conversion idea intrigues you, please contact us for a full analysis of all the relevant variables.

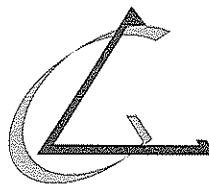
Watch out for Alternative Minimum Tax (AMT)

While many recent tax-law changes have been helpful in reducing your 2010 regular federal income tax bill, they didn't do much to reduce the odds that you'll owe the dreaded AMT. Therefore, it's critical to evaluate all tax planning strategies in light of the AMT rules before actually making any moves. Congress hasn't yet extended the "AMT Patch" to 2010 meaning that the AMT exemption amounts will decrease significantly from 2009 levels. We expect legislation toward the end of the year that would remedy this issue, but there are certainly no guarantees.

Tax Changes for Individuals Stemming from 2010 Health Care Legislation

The new law contains a number of tax provisions that impact individuals with most becoming applicable several years from now. A few of the more significant items (and start dates) include:

- A mandate to carry health insurance - failure results in penalty assessment. (2014)
- Premium assistance credits to purchase health insurance. (2014)
- Medicare tax increases (see above discussion). (2013)
- Medical expense deduction floor will be raised from 7.5% to 10%. (2013 / 2016 for those age 65+)
- Limit on reimbursement of over-the-counter medications from HRAs, HSAs, FSAs, and MSAs. New law requires a prescription for tax free reimbursement. (2011)
- Health flexible spending arrangements (FSAs) will be limited to \$2,500. (2013)



Estate Planning

As you know, legislation passed in 2001 provided for a gradual reduction and in 2010, an elimination of the estate tax. So, currently there is no estate or generation-skipping transfer (GST) tax for individuals who die this year. This also created changes to the income tax basis rules for property acquired from a decedent. Although Congress has been talking about repealing this elimination of the estate tax since last fall, as of today, there is been little progress in doing so. Without further action, 2011 will bring back the estate tax at 2001 levels.

This also creates issues as to how formula clauses in wills and trusts using estate or GST tax terms (e.g., "the applicable exclusion amount," or "the marital deduction") will be construed, if the decedent dies in 2010. Several states have addressed this situation by enacting laws providing a special rule of construction under which formula clauses that refer to certain estate and GST tax terms generally will be construed as referring to the federal estate tax and GST tax laws which applied to estates of decedents dying on Dec. 31, 2009. These statutes could impact the amount that will pass under one's will to a person's spouse and children. We urge you to consult with your attorney to see how the uncertainty in the estate tax may affect your estate plan.

Now some thoughts related to Business Tax Planning.....

Big Section 179 Deduction

Your business may be able to take advantage of the temporarily increased §179 deduction. Under the §179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2010, the maximum §179 deduction is \$250,000 (same as last year). In 2011, the maximum deduction is scheduled for a drastic reduction to only \$25,000. However, since tax rates will increase after 2010, it may be more advantageous to forgo the accelerated write-off to preserve deductions in future, higher tax rate years. Some planning may be helpful to ensure you are maximizing your depreciation deductions.

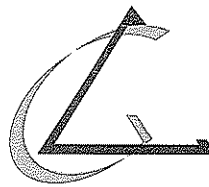
Longer Carryback Period for Net Operating Losses (NOLs)

Legislation passed last year allows businesses to carry back Net Operating Losses (NOLs) generated in tax years beginning in 2009 for up to five years (versus the two-year carryback rule that usually applies). If your business uses a fiscal tax year (say one that began last October), you may still have time to take actions that will create or increase an NOL for the current tax year. That NOL can then be carried back for up to five years to recover taxes paid in those years.

Claim New Health Insurance Tax Credit for Small Employers

Qualifying small employers can claim a new tax credit that can potentially cover up to 35% of the cost of providing health insurance coverage to employees. A qualifying small employer is one that: (1) has no more than 25 Full-time Equivalent (FTE) workers, (2) pays an average FTE wage of less than \$50,000 and (3) has a qualifying healthcare arrangement in place.

The allowable credit is quickly reduced under a complicated two-tiered phase-out rule when the employer has more than 10 FTE employees or an average FTE wage in excess of \$25,000. Please contact us to see if you qualify and to estimate your credit.



Social Security Tax Exemption for Wages Paid to New Hires

Wages paid to a qualified new employee between March 19, 2010 and December 31, 2010 are exempt from the employer's portion of the Social Security tax (the employer portion equals 6.2% of wages up to \$106,800). The exemption doesn't apply to the employee's portion of the Social Security tax (also 6.2% of wages of up to \$106,800). Qualified new employees are full-time or part-time workers who: (1) start work after February 3, 2010 and by no later than December 31, 2010, and (2) were not employed more than 40 hours during the 60-day period ending on the start date. The new worker cannot displace a current employee-unless that person quit voluntarily or was discharged for cause. Wages paid to workers who are related to an owner of the employer may be ineligible. The exemption is claimed on the business' quarterly payroll tax return beginning with the 2nd Qtr, 2010. Please contact us if you would like assistance determining if your business qualifies for this tax break.

Tax Credit for Retaining New Hires

Above and beyond the Social Security tax exemption, employers can also claim a new tax credit of up to \$1,000 for wages paid to each qualified new employee (defined the same way as for the Social Security tax exemption). However, this break has some additional requirements. The worker must remain on the payroll for at least 52 consecutive weeks, and wages during the second 26 weeks must equal at least 80% of wages paid during the first 26 weeks. The credit equals the lesser of (1) 6.2% of qualifying wages paid during the 52-consecutive-week period or (2) \$1,000. To claim the maximum \$1,000 credit, the worker must be paid at least \$16,130 during the 52-week period. If the worker is also eligible for the Work Opportunity Tax Credit, the business can choose one tax benefit or the other – no double dipping.

Increase in Form 1099 Reporting Requirements

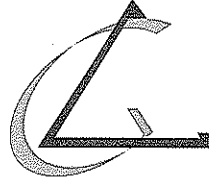
In general, information returns must be made by every person (payor) engaged in a trade or business who makes payments, aggregating \$600 or more in any tax year to another person (payee) in the course of the payor's trade or business. The information returns must be filed with IRS and corresponding statements must be sent to each payee. For payments made after Dec. 31, 2011, the Affordable Care Act adds payments of "amounts in consideration for property" and "gross proceeds" to the list of payments subject to reporting.

Payments to corporations, exempt organizations, governmental entities, international organizations, and retirement plans are generally exempt from these reporting requirements. However, for payments made after Dec. 31, 2011, the Affordable Care Act modified the law to now define the term "person" as any corporation that is not an organization exempt from tax under Code Sec. 501(a). Thus, payments to corporations that are not tax-exempt may be subject to information reporting, starting in 2012. This will be a significant administrative burden for many businesses and the IRS is currently soliciting comments on this issue. We will let you know if any additional guidance is issued.

Extenders

The drama surrounding the extenders bill currently before Congress appears to be far from over. Numerous individual and business provisions have expired and Congress has been unable to agree on extensions. While the House passed its version of the bill, the Senate's modified version currently doesn't have the votes needed for passage. We'll let you know if/when a final version becomes law.

Items affecting businesses that are part of the legislation include the R & D credit, the 15-year write-off of leasehold improvements, wage credit for active military reservists, and AMT credits for corporations making domestic investments. Items affecting individuals include the itemized deduction for sales tax, additional standard deduction for real estate taxes, above-the-line deduction for tuition, and tax-free distributions from IRA's for charitable purposes. Proposals to help pay for the extensions incorporate a new requirement that investment fund managers pay ordinary income tax on a significant percentage of carried interest and the application of self-employment tax on the profits of certain S Corporations that provide professional services.



Conclusion

As we said at the beginning, this letter is intended to give you just a few ideas to get you thinking about tax planning moves for the rest of this year. Please don't hesitate to contact us if you want more details or would like to schedule a tax planning strategy session. We are at your service!

Best regards,

Libman, Goldstone, Kopperman + Wolf

Libman, Goldstone, Kopperman & Wolf

IRS Circular 230 Disclosure: To ensure compliance imposed by the IRS, we inform you that any tax advice contained in the body of this letter (including attachments) is not intended or written to be used and cannot be used, by the recipient for the purpose of (i) avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

The information in this letter is not intended for use without personalized professional assistance. If you need to discuss any issues in this letter, please contact your tax advisor.