November 4, 2009

Dear Clients and Friends,

As we approach year-end, it's time to focus on tax planning to save you money, both on your 2009 return and in future years. The federal income tax environment is fairly favorable right now, but that is not likely to continue beyond 2009. Before we get to specific suggestions, remember that effective tax planning requires considering, at a minimum, both 2009 and 2010. Without a multiyear approach, you can't be sure that tax planning to lower your taxes on your 2009 return won't backfire and cost additional money in the future. Looking into the future is especially important this year because of the increase in individual income tax rates that will most likely come in 2011 (see item M, below).

Normally, because of the time value of money, it's better to pay taxes later rather than sooner. Therefore, strategies that defer income from the current year to later years and those that move deductions from later years into the current year are always popular. How do you shift income and deductions between tax years? The most common techniques involve focusing on income or deductions that you can easily control. Deductions like real estate taxes, charitable contributions, and state estimated tax payments are easy to control in terms of when they are paid. If you own a business, depreciation on your 2009 fixed asset purchases is also controllable, as there are many different options for depreciation in 2009. Cash basis businesses can control the amount of expenses that they do or do not pay by the end of the year. Controlling income is somewhat more difficult.

The above strategy may not be appropriate if your 2009 tax rate will be lower than your 2010 tax rate (by more than the time value of money). In that case, consider the opposite strategy—pushing income into 2009 and deferring deductions into 2010.

Here are some specific tax planning strategies that may apply to you:

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A. Alternative Minimum Tax (AMT)

Individuals must compute their income taxes under two systems—the regular tax system and the Alternative Minimum Tax (AMT) system—and pay the higher of the two amounts. When introduced many years ago, the AMT targeted and normally only applied to high-income taxpayers who benefited too much from certain tax breaks.

Appleton	**Fond du Lac**	**Green Bay**	**Manitowoc**
920-731-8111	920-921-2953	920-436-7800	920-684-5500
Milwaukee	**Oshkosh**	**Sheboygan**	**Stevens Point**
414-463-4411	920-235-0590	920-458-0341	715-344-9400

Today, however, most taxpayers cannot ignore AMT. Therefore, the first step in tax planning is to assess your exposure to AMT. Tax planning for AMT is often dramatically different than planning for regular tax. In fact, it's sometimes backwards.

Who is at the highest risk for AMT? Typically, a married couple with adjusted gross income (AGI) between $150,000 and $600,000 will be subject to AMT. Taxpayers who deduct a significant amount of state and local taxes (income or property), miscellaneous itemized deductions (like unreimbursed employee business expenses), or claim multiple dependents are especially vulnerable. Those who recognize a large capital gain or exercise incentive stock options during the year are also vulnerable.

If a taxpayer is subject to AMT on a recurring basis, there is often very little that can be done to eliminate or reduce the impact of AMT. On the other hand, if a taxpayer is subject to AMT only sporadically, AMT can be controlled. By timing the payment of the deductions that cause AMT (state income taxes, property taxes, miscellaneous itemized deductions) a taxpayer may be able to reduce or eliminate AMT.

In certain situations, prior years' AMT tax will generate an AMT credit. This happens when the AMT results from timing differences (i.e. depreciation, stock option exercise), as opposed to permanent differences (i.e. exemptions, state/local taxes, employee business expenses). An AMT credit normally cannot be used when a taxpayer is in AMT. However, those taxpayers that have an AMT credit generated at least 4 years ago can use some of their AMT credit, even if they are in AMT. For some taxpayers, especially those who have exercised incentive stock options in the past, the amount of AMT credit they can use in 2009 could be substantial.

B. Manage Your Adjusted Gross Income (AGI)

Many tax breaks are only available to taxpayers with AGI below certain levels. Some common AGI-based tax breaks include the $1,000 child tax credit, the Hope Scholarship college credit (expanded and renamed the American Opportunity Tax college credit starting in 2009), the Lifetime Learning college credit, the higher education deduction, the $25,000 rental real estate passive loss allowance, and the exclusion for social security benefits. In addition, taxpayers with 2009 AGI in excess of $166,800 begin losing part of their itemized deductions. Strategies that lower your income will reduce your taxable income and may also help increase some of your other tax deductions and credits.

C. Charitable Giving Strategies

In order to deduct a charitable contribution, you must have the proper substantiation. You cannot deduct any cash contribution under $250 unless you retain either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets certain requirements. For cash donations of $250 or more, a bank record is not enough. You must obtain a charity-provided statement that meets tax law standards. Also, you cannot deduct donations of used clothing and household items unless they are in good used condition or better. This includes furniture and furnishings, electronics, appliances, linens, and the like. Be sure to keep a list and photo (to help establish the item's condition) of donated items. For non-cash contributions of $250 or more, you will also need a written statement from the charity that meets the requirements.

Giving appreciated stock is also a good strategy. The charitable contribution deduction is based on fair market value, not cost basis (purchase price). Therefore, you get the benefit of a larger deduction without having to recognize income on the appreciation. However, do not donate depreciated stock as the loss is not deductible. In this situation, sell the stock first to trigger the capital loss and then donate the cash from the sale.

In 2009, a taxpayer 70½ or older can directly donate up to $100,000 (total of $200,000 for a joint return) of an IRA directly to a qualified charity and not trigger any income on the IRA distribution. However, there is no deduction for the charitable contribution. As discussed above, this strategy helps control AGI. It also is good for those taxpayers that make significant charitable contributions and are hitting the AGI limits on charitable contribution deductions.

D. Standard Deduction vs. Itemized Deductions

If your itemized deductions are very close to the standard deduction ($11,400 for a married couple in 2009), you might benefit from a strategy called “alternating year” or “bunching.” This strategy entails taking the standard deduction one year and itemizing the next year. In the year that the standard deduction is claimed, all itemized deductions would be paid in the following year. Then in the year that itemized deductions are claimed, there are two years’ worth of deductions to claim – both the prior year and the current year. Since many itemized deductions can be controlled in terms of when paid (real estate taxes, charitable contributions and state estimated tax payments) this strategy can be very effective in the proper circumstances. If you can “bunch” effectively over two years, your total deductions will be larger than if you itemize the same deductions every year.

E. Kiddie Tax Alert: Will Your Child Be Under Age 19 or Age 19-23 and a Full Time Student?

When Kiddie tax applies, a portion of a child’s unearned income (typically from investments or income from an S-corporation or partnership/LLC) gets taxed at the parents’ higher marginal rate rather than at the child’s lower marginal rate. Kiddie tax applies to a child who is under age 19 at the end of the year. In addition, Kiddie tax applies to a full-time student who will be age 19–23 at the end of the year if the child’s earned income (such as wages) for the year does not exceed half of his or her support.

Note that Kiddie tax rules for kids that are age 19–23 and full time students might apply even though a parent does not claim the child as a dependent. The rules for when a child can be claimed as a dependent are very different from the Kiddie tax rules.

If Kiddie tax will impact your children, tax planning opportunities available by shifting income to your children will be limited.

F. Strategies Involving Your Securities

Harvesting Capital Losses. Many taxpayers have significant capital loss carryovers to 2009, created by capital loss harvesting done in 2008 (remember, only $3,000 of net capital losses are deductible each year; the balance carries over to future years until used against capital gains). Therefore, unless you have net gains that are not offset by your capital loss carryforward, claiming additional losses before year-end won’t be beneficial for 2009. Of course, you should always consider your investment strategy—not just your tax situation—when triggering losses and gains.

If you own mutual funds, be aware of capital gain distributions in December 2009. Check the websites of your mutual fund companies for an estimate of the dividends that will be paid in December. Capital losses can be triggered to offset the capital gain distributions. Surprise capital gain distributions can ruin your tax planning strategies.

When triggering losses, keep in mind the wash sale rules. If you sell an investment at a loss and repurchase the same security within 30 days before or 30 days after the sale, the loss is not deductible.

Take advantage of the 0% capital gain rate. In 2009, there is a 0% rate on long term capital gains and qualifying dividend income. For those taxpayers whose 2009 ordinary taxable income (ordinary income less standard/itemized deductions and personal exemptions) does not exceed the top of the 15% tax bracket ($67,900 for a joint return), a 0% rate applies to the long term capital gains and qualifying dividends that fills the spread between ordinary taxable income and the top of the 15% tax bracket. In order to take advantage of the 0% rate, keeping the amount of ordinary taxable income to a minimum is critical. This can be done by controlling income and timing of deductions.

The 0% rate is currently in the law through 2010. Children also are subject to the 0% tax rate but because of the tightening of the Kiddie tax rules, they may not receive much benefit.

Give Appreciated Securities to Your Child (or Grandchild). A great way to reduce the tax hit on an appreciated security is to gift it to your child or grandchild. The child can hold the security until a year when the Kiddie tax doesn’t apply and then sell it.

Remember that giving the security to your child or grandchild is considered a gift. You can use your annual $13,000 gift tax exclusion to shelter the transaction from any gift tax. For larger gifts, you can use up part of your $1 million

lifetime gift tax exemption to avoid any gift tax hit. However, dipping into your $1 million exemption could result in a higher estate tax bill after you die.

Even if Kiddie tax does apply, any tax triggered by a child/grandchild that is in college might be partially or fully offset with one of the various college credits that are available. Therefore, gifting appreciated securities to a child/grandchild can still be very tax effective.

Timing of capital gains. The timing of when to pay tax on a large capital gain is a critical decision for 2009 and future years due to the future tax rate increase in capital gains. See item M for more information.

G. Principal Residence Energy Credits

In 2006 and 2007, IRS allowed a 10% credit for certain energy efficient property installed on a taxpayer's primary residence. The credit had a lifetime maximum of $500. Why the history lesson? Congress brought the credit back for 2009 and 2010, with some nice enhancements. The credit rate is now 30%, and the aggregate credit limit for both years is now $1,500. Further, if you took up to $500 credit under the old rules, you get a new $1,500 amount for 2009 and 2010. Items eligible for the credit include insulation, exterior windows and doors, heat pumps, water heaters, central air systems, pigmented metal roofs, asphalt roofs with cooling granules, biomass fuel stoves and other improvements that improve energy efficiency. You can rely on the manufacturer's certification that these items meet the required energy improvement standards for the credit – just be sure to keep this certification as part of your tax records. In addition, certain "high tech" improvements, such as wind turbines, solar panels, etc. are eligible for even higher credits.

H. IRA and Retirement Plans – Distribution Planning

Normally, for those that are age 70½, a required minimum distribution is required to be taken from your retirement plan, other than Roth IRAs which don't require minimum distributions. Under these rules, a taxpayer must take a minimum amount each year from their retirement accounts. You can always take out more than the required amount, but anything less is subject to a 50% penalty on the shortfall.

For 2009 only, a minimum distribution does not need to be taken. This law was passed in late 2008 because of the decline in the stock market. If you have already taken a minimum distribution for 2009, you have until November 30, 2009 to "undo" it and put it back in to your retirement plan. Please note that for IRA accounts only, you can "undo" only **one** distribution, so if you are receiving your minimum distribution monthly, only one of the monthly payments can be undone.

I. Conversions to Roth IRAs

Roth IRAs are a significant tax planning opportunity for many taxpayers and are potentially more beneficial than traditional IRAs or other retirement plans. One significant advantage of Roth IRAs is that minimum distributions never need to be taken. Another is that if a distribution is taken, none of it is taxable, including any earnings on the account, once certain holding periods are met. Therefore, money contributed today to a Roth IRA can grow tax free for your lifetime and beyond. The power of tax free compounding for many years is substantial.

In 2009, a taxpayer that has AGI of under $100,000 is eligible to convert a portion or all of their traditional IRA accounts to a Roth IRA. The amount converted is taxable to the extent IRA contributions were deductible, plus the earnings on the account. Because of the horrible performance of the stock market, IRA values are low. This might be a good time to convert your traditional IRA to a Roth IRA. In addition, converting a traditional IRA to a Roth IRA may be a good way to offset business losses or prevent the wasting of deductions and personal exemptions.

For 2010, a huge opportunity exists for those taxpayers with AGI of more than $100,000. Starting in 2010, the AGI limitation is permanently repealed. All taxpayers will now be eligible to do a Roth IRA conversion. In addition, for 2010 conversions only, you can elect to recognize all the income in 2010 or spread the income ratably over two years, 2011 and 2012. The decision to pick up the income in 2010 or in 2011/2012 is based on the tax bracket you will be in for each of those years and the time value of money. Please consider the increase in tax rates (see item M).

If you did a conversion to a Roth IRA earlier in the year, you can "undo" (recharacterize) some or all of the Roth conversion back to a traditional IRA and then reconvert it to a Roth IRA. It would be wise to consider this if the IRA account has dropped in value since being originally converted. There are time constraints that must be followed if you do this. This rule basically allows you to pick exactly the amount of conversion you would like to pay tax on.

The decision to convert a traditional IRA account to a Roth IRA account is complex, and based on several factors—your tax bracket now and in the future, how long the account can grow, future cash needs, the ability to pay the income tax on conversion from outside the IRA, and estate planning objectives.

J. IRA Contributions

Don't forget to make your 2009 traditional or Roth IRA contributions before the due date (4/15/10) of your tax return. For 2009, combined Roth and traditional IRA contributions generally can be made up to the lesser of (1) $5,000 ($6,000 if age 50 or older by the end of 2009) or (2) 100% of compensation. Compensation includes wages, salaries, other amounts derived from or received for personal services actually rendered including self-employment income, and alimony. For married couples, IRA contributions up to $5,000 ($6,000 if age 50 or older by the end of 2009) can be made for each spouse if the combined compensation of both spouses is at least equal to the contributed amount and they file a joint return.

If neither you nor your spouse (if you're married) are active participants in certain retirement plans, traditional IRA contributions are fully deductible. Otherwise, the amount of the traditional IRA contribution that is deductible will be limited when your AGI exceeds certain limits. Special rules apply for SEP plans—call us for information.

Roth IRA contributions are never deductible. Nevertheless, it's hard to beat a Roth IRA because of the availability of tax-free distributions if you satisfy certain conditions, the lack of required minimum distributions at age 70½, and the option of withdrawing your contributions tax-free and penalty-free at any time (once certain holding periods are met). Unfortunately, Roth IRA contributions are not allowed once your AGI exceeds $176,000 if you're married and file jointly or $120,000 if you're not married.

If you have earned income, but don't qualify for a Roth IRA or a deductible traditional IRA, you may still want to make a nondeductible contribution to a traditional IRA to take advantage of the tax deferred growth such accounts provide. Making nondeductible contributions might also make sense to allow you to take advantage of a Roth IRA conversion (discussed earlier).

K. Tax Planning at the Office

401(k) Plans. Contribute as much as you can, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match. If your employer offers a Roth 401(k) feature, consider if deferring into a Roth 401(k) would be beneficial.

Cafeteria Plan Flexible Spending Accounts (FSAs). If your company has an FSA, before year-end you must specify how much of your 2010 salary you wish to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying child care costs. One word of caution, though: FSAs are "use-it-or-lose-it" accounts. Thus, you don't want to set aside more in such an account than what you'll likely have in qualifying expenses for the year.

Make sure you drain your current FSA by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: over-the-counter drugs (e.g., aspirin and antacids), new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early. Some plans may allow the 2009 balance to be used for expenses incurred within the first 2½ months of 2010.

For married couples when both spouses have access to an FSA, they will need to decide whose FSA to use. If one spouse's salary is likely to be higher than the FICA wage limit (which is $106,800 for 2009 and 2010) and the other spouse's will be less, the one with the smaller salary should fund as much of the couple's FSA needs as possible. The reason is the 6.2% social security tax levy stops at the FICA wage limit (and doesn't apply at all to money put into an FSA). Thus, for example, if one spouse earns $120,000 and the other $40,000 and they

want to collectively set aside $5,000 in their FSAs, they can save $310 (6.2% of $5,000) by having the full amount taken from the lower-paid spouse's salary. Of course, either way, the couple will also save approximately $1,500 in income and Medicare taxes because of the FSA.

Adjusting Federal and State Income Tax Withholding. If it looks like you are going to owe income taxes for 2009, consider bumping up the federal and/or state income taxes withheld from your paychecks now through the end of 2009 so that your total tax payments (estimated payments plus withholdings) equal the lower of 90% of your estimated 2009 liability, 100% of last year's liability (110% if your 2008 AGI exceeded $150,000), or—new for 2009—90% of last year's liability if more than 50% of your 2009 gross income is from a qualifying small business. Hitting one of these thresholds will prevent an underpayment penalty. Alternatively, consider reducing your withholding if you anticipate a large refund.

L. For Your Business

Depreciation. Claiming the right amount of depreciation is critical to maximize your tax savings. Sometimes, taking less depreciation is better than taking more. Looking at 2009 tax brackets as compared to 2010 is very important when it comes to making depreciation decisions. Following is a brief summary of the depreciation rules available for 2009:

- Increased Section 179 amounts: For **tax years starting in 2009,** the Section 179 expensing amount is $250,000 for those taxpayers that purchase and place in service under $800,000 of Section 179 property (generally tangible personal property and software). The 2010 amount is currently scheduled to be approximately $134,000. While a $250,000 deduction might sound like a good thing, consider your future tax brackets and make sure you are getting the best deduction possible for your fixed asset purchases. It is possible that Congress will extend the increased Section 179 into 2010.
- Bonus depreciation: For new (not used) assets purchased and placed in service **during calendar year 2009** that have a tax life of 20 years or less, 50% bonus depreciation can be claimed. Basically, one half of the cost of the asset is immediately written off and the remaining half is then depreciated over its normal tax life. For a 5-year asset subject to bonus depreciation, 60% of the purchase price will be deducted as depreciation expense in 2009. For a 7-year asset, the amount is 57%. Property subject to bonus depreciation includes tangible personal property and qualified leasehold improvements, but not qualified restaurant or retail improvements (see next items). It is possible that Congress will extend the bonus depreciation into 2010.
- Faster Depreciation for Qualified Leasehold and Qualified Restaurant Improvements: Favorable 15-year straight line depreciation is allowed for qualified leasehold and restaurant improvements (which would normally have a 39-year life) that are placed in service by December 31, 2009. For 2009, a new building is included in the definition of qualified restaurant improvements.
- Faster Depreciation for Qualified Retail Improvements: For the first time ever, qualified retail improvements property placed in service in calendar year 2009 get favorable 15-year straight line depreciation vs. a longer 39-year life. Qualified retail improvements are any improvements to the interior of a building more than 3 years old that is open to the public and used in selling tangible personal property to the general public. Improvements that are not eligible include enlargement of the building, an elevator or escalator, structural components of common areas or the internal structural framework of the building.

Business Charitable Donations. Recent changes have extended enhanced deductions for certain types of charitable donations made through 2009. C corporations have always been given special treatment when inventory is donated to the ill, needy, or infants. The two recently extended deductions available to C corporations are for donations of computer equipment and software and another for qualified book contributions. In addition, all businesses get an enhanced deduction for donations of food inventories, extended through 2009. If your business plans entail such donations, you'll want to complete them before the end of the year.

Consider Paying a Dividend. If you are a shareholder in a closely held C-corporation, the current federal income tax rate structure is helpful to your cause. If the corporation pays you a taxable dividend, the dividend will be subject to a 0% or 15% tax rate in 2009. If your personal taxable income is low enough, a dividend may offset

potentially wasted deductions or personal exemptions. This might be a very effective strategy considering the impact of future tax rate increases (see item M, below).

Employ Your Child (or Grandchild). If you are self-employed, don't miss an opportunity to employ your child (or grandchild) before the end of the year. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child or grandchild, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to a traditional or Roth IRA. Children with IRAs, particularly Roth IRAs, have a great start on retirement savings since the compounded growth of the funds can be significant.

Remember a couple of things when employing your child or grandchild. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college or entering soon, having too much earned income can have a detrimental impact on the student's financial aid eligibility.

M. Future Tax Rates

Last year at this time, we commented on then President-elect Obama's promise to raise taxes. To date, there are no tax increases being proposed. However, as part of the tax law passed in 2001, which created the lower tax rates that are in place for 2009, tax rates jump back up in 2011 to the 2001 rates. This means that the ordinary income tax brackets which are now 10%, 15%, 25%, 28%, 33% and 35% will increase to 15%, 28%, 31%, 36% and 39.6%. Capital gain rates currently at 0% and 15% will increase to 10% and 20%. Qualifying dividend rates currently at 0% and 15% would disappear, and be taxed at ordinary income rates. Because this is currently in the tax law, Congress only has to do nothing for rates to increase. (NOTE: The Obama Administration has proposed extending the 0% and 15% tax rates for qualified dividends and capital gains, but only for taxpayers with income up to $250,000 joint and $200,000 single. This would take an act of Congress to become effective.)

Because of this scheduled increase, considering current and future tax brackets becomes very important. In any decision, the time value of money must also be considered. The time value of money may or may not offset any increase in tax rates. In other words, paying taxes later might not be better depending on what rate you will be subject to.

N. Wisconsin Tax Law Changes

Wisconsin passed a few notable tax law changes in 2009, retroactive to January 1, 2009. The first is that the top tax bracket is now increased from 6.75% to 7.75% for taxable income exceeding $300,000 for married couples and $225,000 for those that are single and head of household. In addition, the exclusion on capital gain income, which was 60%, is reduced to 30%.

In Conclusion

Through careful planning, it's possible your 2009 tax liability can still be significantly reduced. But don't delay. The longer you wait, the less likely it is that you'll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they're no substitute for personalized professional assistance. Please call us with any comments or questions that you may have.

Sincerely,

Schenck SC