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Dear Client:

With much of the focus in 2009 understandably on the state of the economy and the financial markets, it nevertheless is important to recognize that a major new tax law was passed during the year and that additional tax-related changes are likely. As we approach the end of the year, it is helpful to review some of the developments and strategies that might be available to reduce your tax bill for 2009 and future years. As always, our financial counselors are pleased to speak with you individually about the strategies that make the most sense for your specific circumstances.

### **Converting to a Roth IRA**

The prospect of retirement is often at the forefront of our clients' minds, especially during challenging economic times. Beginning in 2010, a new opportunity will provide many with a tax-mitigation tool that previously was unavailable to them – the Roth IRA.

Roth IRAs have two major advantages over traditional IRAs. First, while distributions from a traditional IRA generally are taxed as ordinary income, qualified distributions from a Roth IRA are not taxable at all. A qualified distribution is one that occurs (1) after the five-year period that begins with the first taxable year for which a Roth contribution is made, and (2) after the taxpayer reaches age 59½, or on account of death, disability, or a first-time home purchase (limited to \$10,000).

Second, Roth IRAs are not subject to the “required minimum distribution” rules. In contrast, traditional IRAs require that the account owner begin to take lifetime minimum distributions in the year after they turn age 70½. Therefore, assuming you do not need to take distributions to meet expenses, a Roth IRA can allow you to leave the account to a beneficiary in a tax-advantaged way.

Historically, only those taxpayers with modified adjusted gross incomes of \$100,000 or less have been permitted to convert assets in a traditional IRA into a Roth IRA. On January 1, 2010, the \$100,000 AGI limit is scheduled to be eliminated. Furthermore, while the amount of any income generated by the conversion of a traditional IRA normally would be taxed at your ordinary income tax rate in the year of conversion, a deferral of that tax is now available. Unless you elect otherwise, none of the taxable income resulting from the conversion would be included in your 2010 income. Instead, half of the income would be deferred until 2011 and the other half until 2012.

In general, a conversion makes the most sense for certain types of client circumstances. Most importantly, you must have the money to pay the tax due on conversion, and it is best if it does not come from the IRA you are converting. Naturally, the more time you have left before retirement, the better, since that gives you more time to recoup the money lost to current taxes.

Second, if you believe that you will be in a higher tax bracket in retirement than you are now, then it likely makes sense to convert and pay the tax now. Many believe that increased government deficits may necessitate higher tax rates in the future. Of course, if you ultimately earn less income in retirement, then you may move to a lower tax bracket at that time, potentially making a conversion less effective.

Whatever your situation, it is worthwhile to consider this opportunity, even if only for tax diversification reasons – it is always helpful to have a source from which to draw funds in retirement with no tax implications at all. As an extra incentive, there is even an “escape clause” in the event that you experience a change in circumstances that makes paying conversion taxes difficult (such as loss of income): you can recharacterize, or undo, the conversion by returning the money to the traditional IRA.

### **The American Recovery and Reinvestment Act of 2009**

This Act, passed in February, was based largely on proposals made by President Obama and was intended to provide a stimulus to the U.S. economy following the economic downturn. The following highlights of the Act may provide opportunities for tax savings:

- **First-Time Homebuyer Credit:** The 2008 First-Time Homebuyer Credit was extended to cover qualified home purchases between January 1 and November 30, 2009, and the amount is slightly more generous. More importantly, the provision requiring eventual repayment of the credit was deleted. The maximum credit is the lesser of (1) 10% of the purchase price, (2) \$8,000, or (3) \$4,000 for those using married-filing-separate status. The credit can be used to offset your federal income tax liability, including any AMT, and is also refundable. The credit, however, is phased out for higher-income individuals. It is possible that Congress may extend this credit for a few more months after the current November 30 deadline.
- **New Vehicle Sales Tax Deduction:** A new deduction is available for state and local sales and excise taxes paid on new vehicles purchased between February 17 and December 31, 2009. The deduction is limited to the amount of taxes on the first \$49,500 of purchase price. This tax break is available whether you itemize deductions or not, and you can claim it on as many vehicles as you have purchased during this time period. This deduction is phased out for individuals whose modified AGI is between \$125,000 and \$135,000 and for joint filers with modified AGI between \$250,000 and \$260,000.
- **Non-Business Energy Property Credit:** This credit, which was not available in 2008, has been reinstated. You may be able to claim a credit for 30% of the cost of certain energy-efficient property or improvements placed in service in 2009 or 2010. This property can include high-efficiency heat pumps, air conditioners, and water heaters. It also may include energy-efficient windows, doors, and insulation materials. The total amount of credit you can claim in 2009 and 2010 is limited to \$1,500.
- **Economic Recovery Payment:** These \$250 tax-free payments were made to most people who live in a U.S. state or territory and receive social security benefits, supplemental security income, railroad retirement benefits, or veterans disability compensation or pension benefits.

- **Making Work Pay Tax Credit:** You may be able to take this credit if you have earned income from work. While most employees are getting this credit through reduced withholding throughout the year, self-employed individuals will be able to file for this credit when they file their 2009 returns. The credit is 6.2% of your earned income but cannot exceed \$400 (\$800 for married individuals filing jointly). The credit is not available if your modified AGI is greater than \$95,000 (\$190,000 if married filing jointly) or you can be claimed as a dependent on someone else's return.
- **American Opportunity Credit:** This education tax break has been amended to include the first four years of post-secondary education and has been increased to \$2,500 per student. The credit is phased out if your modified AGI is more than \$80,000 (\$160,000 if married filing jointly). In addition, the definition of "qualified tuition and related expenses" has been expanded to include computer technology. For 2009 and 2010, education-related "529 plans" also can be used to pay for computer software, computers, computer fiber optic cable, and Internet access that are used by the beneficiary while enrolled at an eligible educational institution.
- **Tax-free unemployment benefits:** Each recipient of unemployment compensation can exclude from taxable income up to \$2,400 of the amount he or she receives during 2009.
- **AMT Patch:** 2009 AMT exemption amounts were increased to \$46,700 (\$70,950 if married filing jointly), slightly higher than 2008 levels.

### Hybrid Vehicle Credit

A federal income tax credit is allowed for the purchase of a qualifying new hybrid vehicle. Credits range from \$1,500 to \$3,000, but credits are phased out once a manufacturer has sold over 60,000 hybrid vehicles in the U.S. Credits for Toyota and Lexus hybrids disappeared after 2007, and credits for Honda hybrids vanished after 2008. Credits for Ford and Mercury hybrids are being phased out presently. As of September, 2009, full credits were still available for hybrids made by Chrysler, GM, Mazda, and Nissan.

### Estate Tax

Currently, the estate tax is scheduled to be repealed in 2010 and return in 2011. It is unlikely that Congress will allow this to happen. It appears that the \$3.5 million exemption amount and the 45% tax rate currently in effect will be extended for one year into 2010.

### Year-End Tax Considerations

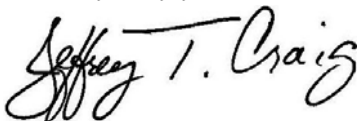
As always, there are multiple other tax-mitigation strategies to consider as the end of the year approaches, including:

- If you don't have a current need for the cash, consider not taking a required minimum distribution from your IRA or other qualified retirement plan. This requirement was suspended for 2009. If you mistakenly took a payout for 2009, the IRS is giving taxpayers a chance to put some or all of the money back into the account if you act before November 30.
- Make every effort to fund retirement plans fully.
- Make a deductible or non-deductible IRA contribution.
- Open or fund a self-employed retirement plan.
- Consider accelerating or deferring income or deductions if your tax situation will change measurably in 2010.
- Consider recognizing capital gains (if you have loss carryforwards) or losses (to offset gains) in your investment accounts.
- If using securities to make charitable gifts, consider donating appreciated shares directly to the charity or selling shares at a loss and donating the cash proceeds.
- Remember the annual gift tax exclusion amount (\$13,000 for 2009) when making gifts.
- Spend the money, if any, in your Flexible Spending Account at work, and consider how much you should defer in 2010.

We hope that this letter is helpful to you in generating tax-planning ideas and strategies for the remainder of 2009. As always, we are pleased to speak with you individually about the strategies that make the most sense for your specific circumstances. Many of you have engaged The Colony Group for tax planning and return preparation, and, as part of those services, your financial counselor will be sure to consider the above strategies for you.

We appreciate the opportunity to be of service to you.

Very truly yours,



Jeffrey T. Craig, CFP<sup>®</sup>, Enrolled Agent  
Director of Tax Services

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