The Colony Group, LLC
Two Atlantic Avenue
Boston, Massachusetts 02110
800-758-8200 617-723-8200
fax: 617-723-6338
www.thecolonygroup.com

October 14, 2010

Re: Year-End Tax Considerations

Dear Client:

As the end of 2010 approaches, lawmakers have not yet passed any legislation relating to future federal income tax rates. Furthermore, they have not extended many of the tax breaks that expired after 2009. While the consequences of such inaction appear clear, it is widely speculated that, depending on the results of the November elections, Congress will act in some way before year end, and taxpayers should be prepared for several possible legislative outcomes.

Sunset Provisions: Tax Rates in 2011

As we have written in prior letters, without Congressional action the tax cuts that were enacted in 2001 will expire – or "sunset" – after December 31, 2010. Specifically, the tax rates on ordinary income would change as follows:

Ordinary Income Tax Rates*					
Single	**2010**	**2011**	**Married (Filing Jointly)**	**2010**	**2011**
0-$8,375	10%	15%	0-$16,750	10%	15%
$8,375-$34,000	15%	15%	$16,750-$68,000	15%	15%
$34,000-$82,400	25%	28%	$68,000-$137,300	25%	28%
$82,400-$171,850	28%	31%	$137,300-$209,250	28%	31%
$171,850-$373,650	33%	36%	$209,250-$373,650	33%	36%
Over $373,650	35%	39.6%	Over $373,650	35%	39.6%

*2011 tax-bracket ranges are subject to inflationary adjustments. In 2011, the 28% bracket currently is scheduled to begin at $56,800 for married taxpayers filing jointly. Alternative minimum tax rates are 26% and 28%.

Also, absent Congressional action, the tax rates on long-term capital gain would change after 2010:

Long-Term Capital Gain Tax Rates*					
Single	**2010**	**2011**	**Married (Filing Jointly)**	**2010**	**2011**
0-$34,000	0%	10%	0-$68,000	0%	10%
Over $34,000	15%	20%	Over $68,000	15%	20%

*2011 tax-bracket ranges are subject to inflationary adjustments. In 2011, the 20% bracket currently is scheduled to begin at $56,800 for married taxpayers filing jointly. Different rates may apply to sales of certain real estate, collectibles, qualified small business stock, and capital assets held for more than five years.

Finally, unless Congress takes action, beginning in 2011 qualified dividends will no longer be taxed at long-term capital gain rates and instead will be taxed at ordinary income tax rates.

Additional Healthcare Taxes Are Coming

Suffice it to say, most taxpayers should anticipate higher taxes in 2011 unless Congress acts to change the above schedules. Subsequently, starting in 2013, the Health Care Reform Act of 2010 is scheduled to subject higher-income taxpayers to an additional 0.9% Medicare tax on earned income over $200,000 ($250,000 if married filing jointly (MFJ)) and a 3.8% Medicare tax on the lesser of the taxpayer's net investment income or modified adjusted gross income in excess of $200,000 ($250,000 if MFJ).

Will Congress Act?

With unemployment at 9.6% and a restrained economic recovery, Congress is under significant pressure to remove any barriers to future growth, such as higher taxes. In his most recent budget, President Obama has proposed that tax rates remain the same for everyone other than taxpayers with income of more than $200,000 ($250,000 if MFJ). These taxpayers would be subject to higher marginal rates of 36% and 39.6%. He also has proposed keeping the current maximum rate in effect on qualified dividends and long-term capital gain for taxpayers under the preceding income threshold, while increasing it to 20% for taxpayers over the threshold. Nevertheless, Congress has not yet adopted the President's proposals.

At this time, there appears to be increasing bipartisan support for continuing to tax qualified dividends at rates that are lower than the rates on ordinary income. Otherwise, we are not likely to have more clarity on the future of tax rates until after the November elections; nor are we likely to have greater clarity on the future of several expiring or expired tax provisions until after the elections. Examples of these provisions include the expired deductions for state sales taxes, teachers' supplies, and college tuition, as well as the extra standard deduction for real estate taxes. Also awaiting resolution are the ability to make tax-free transfers from an IRA to charities and a possible increase to the alternative minimum tax exemption.

The uncertainty surrounding future tax rates and various tax incentives makes year-end tax planning unusually difficult this year. Conventional wisdom states that, under normal circumstances, taxpayers should defer income and accelerate deductions whenever possible. Yet, if a taxpayer anticipates being subject to higher tax rates next year, it actually might be better to do the opposite – accelerate income to take advantage of today's lower rates and delay deductions until rates are higher. Ideally, some or all of the outstanding issues – future income tax rates, the status of expiring and expired tax breaks, the 2010 AMT exemption amount, and even estate tax exemptions and rates – will be resolved following the coming elections.

Recent Tax Changes

While we continue to wait for resolution regarding future tax rates and other measures, Congress has not been idle. In September, the Small Business Jobs Act of 2010 was enacted. The Act includes a package of small business tax incentives, including an extension of bonus depreciation, increased Section 179 expensing, an exclusion from income of the gain on qualified small business stock, increased start-up expense deductions, and the ability of self-employed individuals to deduct the cost

of health insurance in the computation of self-employment tax. In order to remain revenue-neutral, the Act includes several revenue-raisers, some of which may affect individual taxpayers:

- Beginning in 2011, eligible state and local government organizations with Section 457(b) retirement plans will be allowed to offer Roth accounts. Section 401(k) and 403(b) plans already are authorized to do so.
- Section 401(k), 403(b), and 457(b) plans can now authorize plan participants to roll over pre-tax account balances into a Roth account within the same plan. The rollover is taxable, except with respect to after-tax contributions. If a rollover occurs in 2010, the income can be recognized ratably in 2011 and 2012.
- Beginning in 2011, individuals who receive rental income from real property must report payments of $600 or more to service providers by issuing Forms 1099. Temporary rentals of a primary residence are exempt.

Year-End Tax Considerations

As always, there are several tax-mitigation strategies to consider as year-end approaches, including:

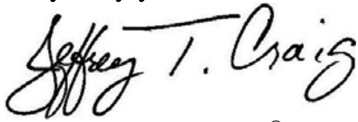
- Consider accelerating or deferring income or deductions if your tax circumstances will change measurably in 2011.
- Make every effort to fund retirement plans in full. At the very least, make sure you are on track to get the maximum possible employer match, if available.
- Make a deductible or non-deductible IRA contribution.
- Open and/or fund a self-employed retirement plan.
- Consider recognizing capital losses (to offset gains) in your investment accounts. Recognizing capital gains also may make sense if your capital gain tax rate will increase in 2011.
- 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.
- Spend the money, if any, in your Flexible Spending Account (FSA) at work, and consider how much you should defer in 2011. Keep in mind that after 2010, FSAs cannot reimburse the cost of over-the-counter medications without a doctor's prescription.
- If you are planning to transfer funds directly from your IRA to a qualified charity, you should consider waiting to be sure that the donation will be tax-free as in past years. Congress allowed this tax break to lapse after 2009, but it may extend it before year end.
- Consider making energy-efficient improvements to your principal residence. You may be eligible for a credit of up to 30% of the cost of certain energy-efficient property placed in service in 2010. The total amount of the credit you can claim in 2009 and 2010 is $1,500.
- If you are considering a Roth conversion, remember that the conversion must take place in 2010 if you want to defer the recognition of income until 2011 and 2012. In future years, the income will be recognized in the year of conversion.

- If you are age 70½ or older, be sure to take a Required Minimum Distribution from your IRA. That requirement was temporarily suspended in 2009, but it is back in 2010.
- Remember the annual gift tax exclusion ($13,000 for 2010) when making gifts.

We hope that this letter is helpful as you consider your tax planning for the remainder of 2010. 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®, Enrolled Agent
Director of Tax Services

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