

OVERVIEW

Typically people rely on a standard set of year-end tax planning techniques such as deferring income to the following year and accelerating deductions into the current year. Examples of these types of tactics are holding off on selling investments with gains until later or paying tax deductions such as property tax or charity donations.

For the year 2010 there's an extra twist on these traditional tax planning techniques. For one thing, we know with certainty what the 2010 tax rates are. But the exact tax rates that will be in effect for 2011 is somewhat uncertain. As the law is currently written, all the tax rates will change for 2011. There's been various proposals to keep the tax rates the same or increase only the top two tax brackets. But so far those proposals have not passed into law. Accordingly, people may want to plan out their 2010 taxes with an eye towards the presumably higher tax rates that might go into effect in 2011. And this means that several traditional tax planning techniques need to be reversed. For example people may want to accelerate income into 2010 to lock in a known tax rate now instead of an uncertain or possibly higher tax rate next year. Similarly people may want to defer any tax deductions until 2011 so those deductions will offset next year's income at presumably higher rates.

WHY WORRY ABOUT 2011 INCOME TAX CHANGES?

Though the 2011 tax year is still several months away, the time to being planning for things like this is right now – before the changes go into effect as these potential income tax rates have the potential to take a big bite out of your income and/or savings accounts.

INCOME TAX BRACKET CHANGES FOR 2011

The Bush tax cuts of 2001 and 2003 are set to expire at the end of 2010. Thus, if Congress doesn't act, the relatively low income tax rates that we've been enjoying (enjoying?) will soon be a thing of the past. They will be replaced by the pre-2001 tax brackets.

In other words, the 10%, 15%, 25%, 28%, 33% and 35% tax brackets that we've grown accustomed to will be replaced by 15%, 28%, 31%, 36%, and 39.6% brackets. The right-most column in the table below details how the brackets may be using 2010 income cutoffs. Except for the 2010 15% tax bracket, the tax rate for all other all other brackets will increase by 3% - 5%.

2010 Individual Tax Rates					Potential 2011 Tax Rate (%)
Single	Head of Household	Married Filing Jointly	Married Filing Separately	Tax Rate (%)	
\$0 - \$8,750	\$0 - \$11,950	\$0 - \$16,750	\$0 - \$8,375	10%	15%
\$8,750 - \$34,000	\$11,951 - \$45,500	\$16,751 - \$68,000	\$8,376 - \$34,000	15%	15%
\$34,001 - \$82,400	\$45,501 - \$117,650	\$68,001 - \$137,300	\$34,001 - \$68,650	25%	28%
\$82,401 - \$171,850	\$117,651 - \$190,550	\$137,301 - \$209,250	\$68,651 - \$104,625	28%	31%
\$171,851 - \$373,650	\$190,551 - \$373,650	\$209,251 - \$373,650	\$104,626 - \$186,825	33%	36%
Over \$373,650	Over \$373,650	Over \$373,650	Over \$186,825	35%	39.6%

CAPITAL GAINS TAX CHANGES IN 2011

In addition to the increased federal income tax brackets, the capital gains tax rates may also be changing (and not for the better). The top rate for long-term capital gains may be rising from 15% to 20%, and the 0% rate for those in the lowest tax bracket may be replaced by a 10% long-term capital gains rate.

2010 Tax Bracket	Capital Gains Tax	
	2010	2011 +
10%	0%	10%
15%	15%	20%
25%	15%	20%
28%	15%	20%
33%	15%	20%
35%	15%	20%

POTENTIAL 2010 YEAR-END TAX MOVES

With both income tax and capital gains taxes set to increase, there are two potential general approaches you may want to consider in order to reduce your overall tax liability: Income Acceleration and Deduction Deferral strategies, both of which are detailed below.

INCOME ACCELERATION STRATEGIES

- Ask your employer to pay out bonuses in 2010 instead of next year thereby accelerating your ordinary income.
- Sell off stocks and other investments with taxable gains in 2010 instead of next year.
- Take IRA distributions in 2010 instead of 2011.
- Convert some or all of your pre-tax IRAs and 401k(k) contributions to a Roth account, and opt to report the income in 2010.

DEDUCTION DEFERRAL STRATEGIES

- Defer paying medical bills, charity donations, property tax and other deductions until next year.
- Hold off on selling losing investments until 2011 when presumably the capital gains tax rate will be higher, and thus losses will have more tax value.

SUMMARY

While it is not yet certain what the final tax picture will look like in 2011, it is likely that taxes for most if not all people will be higher. As such, there are several approaches to evaluate and consider for implementation once the tax situation is known in greater detail.