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Taxing Matters

The dreaded time of year is here — N.H. experts offer some advice

Good riddance, 2009. The year saw the real estate market implode, financial markets melt down, returns on investments nearly disappear, and entire industries dangling by the lifeline of government largess.

But now that the year is nearly out, things must get better because they can't get much worse, right?

Not so fast. Tax season is closing in, and despite the near-depression, Congress and the president have not done very much to ease the April burden. In fact, in early December, many wage earners got the unpleasant news that the revised tax tables issued last spring to give workers a little more pocket change did not account for two-income families. The result: lower refunds for people who "over withhold" and taxes due for those who thought they were paying just enough.

"If withholdings got screwed up because of the tax credit phenomenon, then I can imagine people thinking all their taxes have been withheld and finding out they owe more," says attorney Newton H. Kershaw Jr. of Devine, Millimet in Manchester. We called him to talk about tax strategies — that is, how to cope with next year's federal income tax filing process in light of financial moves we might have had to make in 2009 just to stay afloat. After all, while the first \$2,400 of unemployment compensation goes untaxed, most people can't live very long on \$2,400.

So maybe you drew on retirement savings for current living expenses. "That's very expensive money," Kershaw says, "so being put into the predicament of having to use it now is financially unfortunate."

Translation: You're going to pay. Although some 401K plans allow you to take out a loan that can be repaid over periods ranging from five to 15 years, the "early distributions" that you might take in a financial pinch have to be repaid promptly or be subject to a 10 percent penalty — on top of regular income taxes on the withdrawal.

"You can only repay it in that tax year, up until the time of filing the return," says lawyer and certified public accountant Paul Mansur with Beliveau Law Group in Salem. "Otherwise, your only way to avoid taxes is to show the funds went to qualified medical expenses, generally the same things that are allowed as deductible medical expenses on your income tax return."

In fact, says attorney Mark Melendy of Melendy Moritz PLLC in Lebanon, most of the tax moves you can make now are targeted at people who need a break the least: "When it comes to tax law changes in the coming year, it's mostly people who have money that are going to be most interested."

For example, if you're rich enough to worry about taxes on the estate you leave behind, you might

be well served to leave it soon. "As of January 1, we don't have an estate tax," Melendy says. That is, unless the recent House action to extend the tax becomes law. "But if they don't act, it could be to your advantage to die in 2010." [At press time, no further action had been taken.]

But, he adds, that advice only applies if your estate is more than the current exemption threshold of \$3.5 million, and only if Congress doesn't reinstate the tax, which it could even do retroactively in early 2010. "It's truly bizarre," Melendy says. "It's one of those quirks that I dare say there's not an estate planner who ever thought we'd be where we are. They had 10 years to get this fixed and they failed to do it."

You're also OK if you withdrew no more than \$10,000 from a retirement account and used it to buy a house. Combined with the federal \$8,000 tax credit for first-time homebuyers, plus the general tanking of housing prices, people who could qualify for a mortgage in 2009 enjoyed some serious benefits.

Others, such as those who were forced to sell their homes to avoid foreclosure, caught more modest breaks. "Under one recent change in tax law, if you sold your house for less than your mortgage and the bank forgives the difference, the IRS doesn't include that as part of your income," Mansur says. "So at least you don't get stuck twice."

On the other hand, if you managed to make money on the sale, you're probably immune from capital gains taxes. Couples can sell their principal residence once every three years and pay no tax on up to \$500,000 in profit (\$250,000 for single filers) provided they meet certain other requirements. Ironically enough, it's such a good deal that it might have even contributed to the real estate crisis.

"That's one of the things that started people buying and flipping houses," Mansur says.

Or, if you had stocks to sell and you didn't lose money in the process, you can try to match them with other stocks that you sold for less than you paid for them in a process called "harvesting losses." You are still realizing losses, but at least you don't compound them by paying more taxes than necessary.

And make no mistake: taxes are definitely necessary. The very worst thing you could possibly do, at least as Mansur sees it, is to hide from Uncle Sam. "Always file the return, and never skip filing because you can't pay. There have been changes that have allowed taxpayers a little more breathing room if you are straightforward with the IRS, but they are also ramping up collection efforts and they won't talk to you until you file." NH