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TAX UPDATE – April 2010

To Our Clients, Business Partners and Friends...

In the immortal words of Oliver Hardy to Stan Laurel: “here’s another fine mess you’ve gotten me into!” (It is not a coincidence that I chose Laurel & Hardy to lead this issue!) Congress actually did something – passed the health care reform package – so now sit back and watch income tax rates increase in 2011 and beyond! Oh, and does anyone think State income tax rates are going to increase too? We certainly do - and you should be planning for it now!

Health Care “Reform”

Congress can’t do anything these days without increasing tax rates on folks making more than \$250,000 a year – but given the current federal budget situation, it is now safe to assume that the expiration of the Bush tax cuts (and the resulting rise in income and capital gains taxes) will occur in 2011. It is also likely that the increases in taxes will “trickle down” to folks in lower income brackets as well. No matter what happens in the mid-term elections this Fall...

Have you heard about the other tax “goodies” in the health care package?

- An increase in the limit before allowable deductions for medical expenses kick-in to 10% of income, from the current 7.5%;
- A new tax of 3.8% on unearned income (interest, dividends, capital gains, etc.) for the over-\$250,000 group of taxpayers; and
- Taxes, penalties and curbs on employer spending on health insurance coverage.

Our guess is that these facts will combine to drive lower spending on corporate health insurance benefits - and more compensation will be used for after-tax employee contributions towards health care costs. It will also cause highly-compensated employees to be more interested in pre-tax savings opportunities. Stay tuned for ideas about how nonqualified plans will be useful in diffusing some of these new tax issues...

2010 Bonus Compensation

Under IRC Section 409A regulations, elections to defer bonus compensation must be made no later than 6 months into the 12-month earnings period. In plain English, this means that for all calendar-year bonus plans, elections to defer from any bonus earned in 2010 (usually payable in early 2011) must be made on or before June 30, 2010. Any 2010 bonuses (those paid in 2011) will be subject to the higher income tax rates that will be in effect at the time of payment.

Therefore, **you are already earning bonus compensation that will be subject to higher Federal income taxes in 2011**. If you don’t want to pay those rates, you need to elect to defer the funds into a nonqualified plan prior to June 30 of this year!

Thank you for the chance to be of service. Please let us know if we can provide you with any additional information related to these or other key employee compensation / benefit issues.