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Client Information Bulletin

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Eight Year-end Tax Moves for 2008

Tax ideas for individuals and business owners

As usual, you may want to utilize some tried-and-true tax strategies as the year winds down. However, there are several interesting twists and turns to year-end tax planning in 2008. Keeping that in mind, here are eight tax moves to consider late this year.

1. **Capital gains and losses**: Depending on your economic situation, you may want to realize capital gains to offset capital losses realized earlier in the year. Any net long-term capital gain for the year is taxed at a maximum rate of 15%. **Even better**: For 2008, the preferential tax rate for long-term capital gain is zero percent for taxpayers in the regular 10% or 15% ordinary income brackets.

As a result, it may be prudent for your children in lower tax brackets to sell securities or other property this year. However, be aware of potential "kiddie tax" complications (*see number* 8).

2. **Business assets**: Under Section 179 of the tax code, a business taxpayer can "expense," or currently deduct, the cost of qualified business assets placed in service during the year. The new economic stimulus act passed earlier this year increases the maximum expensing allowance for 2008 to $250,000. (It had been scheduled to be $128,000.) In addition, a business may qualify for 50% "bonus depreciation" deductions for certain assets placed in service before 2009.

The enhanced Section 179 deduction may be combined with bonus depreciation and regular depreciation deductions. See your tax adviser for more details.

3. **Alternative minimum tax**: Under the complex calculation for the alternative minimum tax (AMT), you may have to effectively pay a higher tax if you have an overabundance of certain "tax preference" items this year. At this time, you should have a professional tax adviser estimate your AMT liability for 2008.

It might make sense to shift some tax preferences to 2009 to avoid or reduce AMT liability. Alternatively, you might accelerate income into 2008 if the AMT rate is lower than your top marginal tax rate.

4. **Charitable donations**: Generally, you can deduct the full amount of cash donations made before the end of the year. If a donation is made by credit card or via the Internet, you can deduct the gift on your 2008 return, even if the charge is not actually paid until next year. However, strict substantiation is now required for monetary contributions.

5. **Medical expenses**: It is well known that you can deduct unreimbursed medical and dental expenses to the extent the annual total exceeds 7.5% of your adjusted gross income (AGI). Try to group non-

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emergency expenses (e.g., new eyeglasses or dental cleanings) in the tax year that provides the best opportunity for a deduction. If you will not qualify for a medical expense deduction this year, you may as well postpone expenses to next year, when possible.

6. Estimated tax penalties: If you do not pay enough federal income tax during the year through withholding or quarterly installments, you may be liable for an "estimated tax" penalty. But no penalty is imposed if annual tax payments for 2008 equal 90% of the current year's liability or 100% of the prior year's tax liability. **Note**: The percentage for the 100% safe harbor is increased to 110% if your AGI for the prior year exceeded $150,000.

7. Business travel: Travel expenses incurred by an employee—including airfare, lodging and 50% of the cost of meals—may be deducted if the trips are business-related. When it is appropriate, you can move up business trips planned for January into December. This allows you to write off the travel expenses on your 2008 return instead of waiting until 2009. **Caveat**: Unreimbursed travel expenses must be deducted as miscellaneous expenses subject to the usual 2%-of-AGI limit.

8. Family income-splitting: You may be able to reduce the overall family tax bill by shifting taxable income from your high tax bracket to family members in lower tax brackets. For instance, you might transfer income-producing assets to your young children, but be aware of the kiddie tax. **How it works**: If the unearned income of a child exceeds $1,700 for 2008, the excess is taxed at the top marginal tax rate of the child's parents.

Beginning in 2008, the kiddie tax applies to children under age 19 or age 24 for full-time students. These higher age limits are triggered if the child's earned income does not equal or exceed half of his or her annual support.

This is only a summary of several year-end tax-planning ideas. With professional assistance, you can develop an overall plan for your situation.

Five Reasons to Consolidate Your IRAs

When it makes sense to simplify investments

If you are like many long-time retirement savers, you may have several IRAs you started up in years gone by. This usually results in a flood of financial statements in your mailbox. But you can cut down on the paperwork—as well as simplify your life—by consolidating your IRAs in one place.

Caution: Before we go any further, remember that all IRAs are not created equal. For instance, you cannot mix and match traditional IRAs with Roth IRAs.

A traditional IRA may include tax-deductible contributions from the time when you were eligible for IRA deductions. The distributions from these IRAs are subject to tax at ordinary income rates. In contrast, contributions to a Roth IRA are never tax-deductible, but future distributions may be completely tax-free if the Roth IRA has been in existence for at least five years.

Similarly, you may forfeit tax benefits if you combine the funds in an IRA you have inherited with your own IRAs. Be aware of these critical differences.

Nevertheless, assuming you have several traditional IRAs that may be combined without any adverse tax consequences, consider these five reasons for consolidation.

1 It is difficult to coordinate your retirement planning strategies if you are spread out all over the place. This enables you to focus on your goals—for example, taking a more conservative approach—by taking your current circumstances into account.

2 One or more of your IRAs may be providing a better return on investment than the others. By moving assets into a single IRA, you can eliminate the IRAs that have not performed as well.

3 Administrative costs can erode your nest egg. Thus, you may save money in fees overall by consolidating IRA assets.

4 It is easier to keep track of your investments. Instead of multiple statements, you will receive just one statement covering all of your IRA investments.

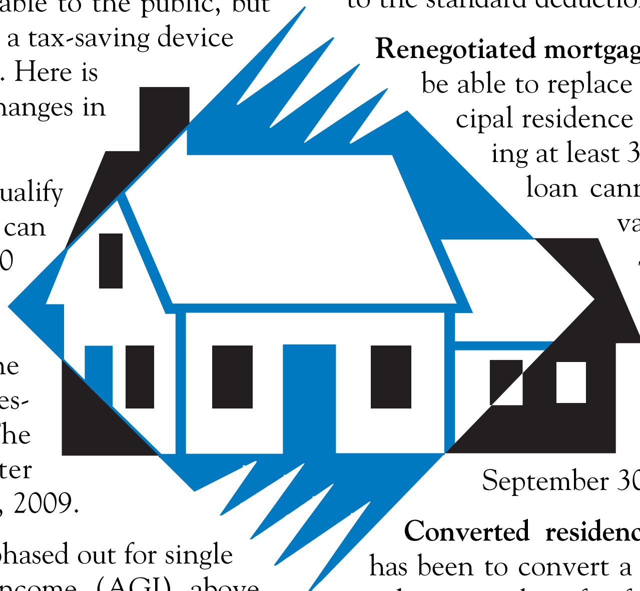
5 Required distributions from your IRAs must begin by the year after the year in which you turn 70½. The amounts of the required distributions are based on all of your IRAs. Therefore, it will be easier to calculate the required distributions.

Of course, you may not want to consolidate your IRAs in order to maintain greater diversity or for personal preferences. Discuss your options with an experienced adviser.

New Ground Rules in the Housing Law

New legislation creates tax breaks for homeowners

The new housing law—which includes the Housing Assistance Tax Act of 2008—features several important provisions for homeowners and lenders. For the most part, the benefits are favorable to the public, but the new law also cracks down on a tax-saving device for certain vacation homeowners. Here is a brief overview of several key changes in the new law.



Home buyer's tax credit: If you qualify as a first-time home buyer, you can claim a tax credit equal to $7,500 or 10% of the purchase price, whichever is less. A first-time homeowner is defined as someone who has not owned a principal residence for the last three years. The home must be purchased after April 8, 2008, and before July 1, 2009.

However, this new tax credit is phased out for single filers with an adjusted gross income (AGI) above $75,000 ($150,000 for joint filers). Furthermore, the credit must be repaid on your tax returns over a 15-year period.

Property tax deduction: If an individual, such as an elderly relative, does not itemize deductions on his or her 2008 tax return, the individual can deduct a $500 property tax allowance ($1,000 for joint filers). If the homeowner's property taxes for the year are less than this special allowance, the deduction is limited to the taxes actually paid. This new deduction may be claimed in addition to the standard deduction on 2008 returns.

Renegotiated mortgages: Under the new law, you may be able to replace an existing mortgage on a principal residence with a new fixed-rate loan lasting at least 30 years. The amount of the new loan cannot exceed 90% of the current value of the property.

To obtain this relief for homeowners, your monthly housing payment (as of March 1, 2008) must exceed 31% of your monthly household income. The program will end on September 30, 2011.

Converted residences: One long-time tax strategy has been to convert a vacation home into a principal residence to benefit from the home–sale exclusion. Generally, the home–sale exclusion can shelter tax on gains of up to $250,000 ($500,000 for joint filers).

For gains realized after 2008, the portion of the gain attributable to nonqualified use of a principal residence does not qualify for the home–sale exclusion. Using the home as a vacation home is a nonqualified use. **Saving grace**: This provision only applies to nonqualified use after 2008.

The new law also includes a wide array of other provisions, including the following:

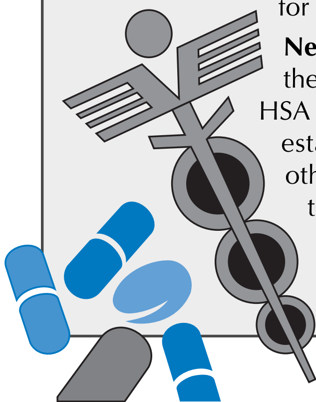
- The loan limits for Fannie Mae and Freddie Mac are increased.
- The low-income housing credit is modified and simplified.
- The rules for REITs (real estate investment trusts) are modified.
- Additional funding is authorized for mortgage revenue bonds.
- The rehabilitation tax credit is enhanced.
- New rules are designed to offer greater protection for homeowners using reverse mortgages.

The scope of the new housing law is immense. To determine the impact on your personal situation, contact a professional tax adviser.

Last Call for HSA Contributions

With a health savings account (HSA), you can deduct contributions made in conjunction with a qualifying high-deductible health insurance plan. Distributions from the HSA are tax-free to the extent they are used to pay for qualified medical expenses.

For 2008, the maximum allowable contribution is generally limited to $2,900 for self coverage and $5,800 for family coverage.



New tax benefit: In a new ruling, the IRS says that you can fund an HSA in full as long as the HSA is established by December 1. In other words, you can still contribute the maximum amount to an HSA for 2008. Any unused amount may be carried over to the following year.

How to Improve Employee Reviews

Steps for a meaningful give-and-take

Typically, a business manager will sit down with his or her employees at the end of each year for a performance review. But is anything really being accomplished? Not if the manager is merely doing the review by rote. Consequently, whatever input the employees provide in these sessions is likely to fall on deaf ears.

Better idea: Employee reviews may be meaningful to both sides if they are handled effectively. Of course, developing a better system of conducting reviews will take a little extra time and effort at first. But the "payoff" will be well worth it. And once you put these procedures in place, it should be easy to follow them each year. Here are a few suggestions for improving the process:

Make your purposes clear. All too often, employees are not exactly sure what the review is supposed to cover. For that reason, they tend to hold back. If pressed on a particular issue, they then become defensive or belligerent—or both. Not only is it a waste of time for your employees, it's also a waste of your own time. On the other hand, if you establish an agenda before meeting with your employees, you are likely to accomplish much more.

Keep the review simple. The most effective reviews are the ones that concentrate on a single purpose. Primarily, you should be interested in helping each employee realize his or her potential. Don't get sidetracked by peripheral issues.

Offer constructive criticism. Employees will be turned off if you simply confront them with a laundry list of complaints. For example, don't wait until the review to tell an employee that he or she is spending too much time on personal business. Those types of problems should be addressed when they occur.

Exchange ideas. The review should not be a one-way street. By giving employees a chance to express their opinions, you are more likely to resolve any problems. Instead of dwelling on what has already occurred, focus on ways to improve the situation.

Get organized. Prepare a list of items you want to go over. Jot down a few notes under each heading. As you proceed, you can check off the items you have discussed to make sure you have covered the most important points.

If all you do is run down an appraisal form, there is little to be gained. Your employees will recognize the difference between a perfunctory review and one with real meaning.

Give Us A Call!

Do you have any questions or comments about this newsletter or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.

Facts and Figures

Timely points of particular interest

➡**Don't Be Greedy**—In a new case, a medical group arranged to sell their practice to a tax-exempt hospital. Prior to the acquisition, the physicians donated their stock to the hospital. They valued the deductions at $400 per share, even though the practice was folding. **Result**: The Tax Court set a value of only $37 a share. Plus, it imposed a 40% penalty for the overvaluation of the donations.

➡**In the Genes**—Are you looking to hire new employees next year? Be aware that the Genetic Information Nondiscrimination Act of 2008 (GINA) was recently signed into law. This new federal legislation protects job candidates from discrimination based on their genetic makeup. **Caveat**: The provisions in GINA affecting hiring practices do not officially take effect until November 21, 2009.

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