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Client Information Bulletin

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Eight New Items on Your 2008 Return

Key changes in store for tax filers

It has been a tumultuous year on the tax front. Several significant new laws and a flood of new regulations and rulings in 2008 have contributed to more than 500 revisions in the federal tax code. Keeping that in mind, here is a roundup of eight key changes on 2008 returns.

1. Homebuyer's tax credit: For the first time ever, a homebuyer may claim a credit equal to the lesser of $7,500 or 10% of the home's purchase price. The credit is available for a principal residence purchased after April 8, 2008, and before July 1, 2009. **Note**: If a home purchased in 2009 qualifies, you can claim the credit on your 2008 return.

2. Zero-percent capital gains rate: Previously, the maximum 15% capital gains tax rate for net long-term capital gain and qualified dividends was reduced to only 5% for taxpayers in the regular 10% and 15% tax brackets. But this 5% rate drops to 0% for 2008. Currently, the 0% rate is scheduled to remain in effect through 2010.

3. Kiddie tax: Beginning in 2008, the kiddie tax generally applies to unearned income above a specified annual threshold received by a child who is younger than 19 years of age (up from age 18 years for 2007) or a full-time student younger than age 24 years. For 2008 returns, unearned income above $1,800 is taxed at the top tax rate of a child's parents.

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4. Small-business deductions: If you own a small business, you can take advantage of an enhanced Section 179 deduction and 50% "bonus depreciation" for qualified assets placed in service last year. The maximum Section 179 allowance—the amount you can currently deduct—is increased to $250,000 for 2008 (up from $125,000 for 2007).

5. Property-tax deduction: Prior to 2008, state and local taxes could be deducted only by filers who itemized their tax deductions. But a law change enables nonitemizers to deduct the lesser of $1,000 ($500 for single filers) or property taxes actually paid on a 2008 return. **Note**: This special deduction was recently extended for the 2009 tax year.

6. Standard mileage rates: In an unusual move, the IRS adjusted the standard mileage rate for business driving midway through the year. The initial rate of 50.5 cents per business mile plus related tolls and parking fees (up from 48.5 cents per mile for 2007) was increased to 58.5 cents per business mile for the last six months of 2008. **Note**: The rate drops down to 55 cents per mile for 2009 (see *Dip in the Standard Mileage Rate*).

7. Itemized deductions: Itemized deductions are reduced for high-income taxpayers with an adjusted gross income (AGI) above a speci-

fied level. The reduction for 2008 begins if AGI exceeds $159,950 for joint filers (up from $156,400 for 2007). For 2008, you forfeit only one third of the amount that would otherwise be lost, as opposed to two thirds in 2007.

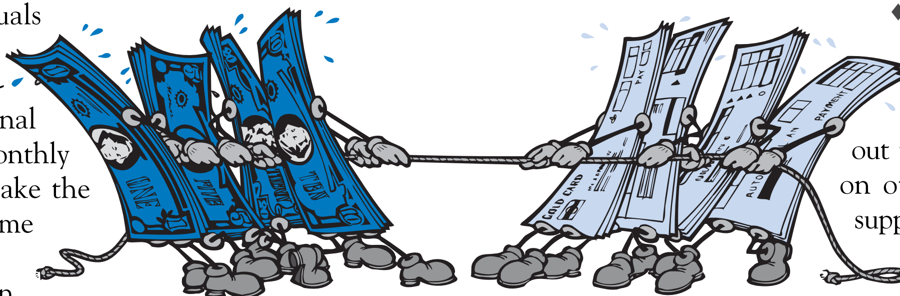
8. **Casualty losses**: Generally, personal casualty losses are deducted only to the extent they exceed 10% of your AGI. However, beginning in 2008, this 10%-of-AGI limit is eliminated for federal disaster-area losses (see *Tax Outlook Under New Casualty Loss Rules*).

Of course, this is only an overview of several key changes for 2008 returns. It is recommended that you seek professional assistance for your personal situation.

How to Improve a Business Budget

Take steps to develop a flexible plan

Some individuals who would not dream of running their personal lives without a monthly budget will not take the time to do the same for their small-business operation. Instead, they try to fly by the seat of their pants. But the same principles that apply to a household budget can be extended to your small business.



In fact, in these uncertain economic times, it can be argued that budgeting is more critical than ever. So what can you do about it? Here are several "common sense" improvements you might make.

♦ **Be conservative.** It is far better to err on the side of understating income and overstating expenses than it is to do things the other way around. That will help eliminate unpleasant surprises at the end of the year. If things work out better than anticipated, consider the surplus to be a bonus.

♦ **Remain flexible.** Essentially, a corporate budget is a projection of the income and expenses of your enterprise. In other words, it is based on calculated estimates at the beginning of the year, but that does not mean it should be rigid. Use your recent history as a guideline, but leave some room for flexibility.

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♦ **Divide up expenses.** Certain costs, such as the monthly rent bill, usually are fixed throughout the year. But dollars spent on other items—for example, supplies and equipment—may fluctuate throughout the year. Identify the unpredictable expenses and separate them. Not only will this provide clarity for your business, it may lead to strategies for minimizing costs.

♦ **Monitor the results.** When your business pays its bills each month, see how the numbers match up against your projections. You may have to adjust your budget to reflect actual income and expenses. Remember that your budget is a "work in progress"—not a finished product.

♦ **Discipline yourself.** Putting a plan down in writing can help you curtail unnecessary expenses. For instance, without a budget you might drive down to the local computer store to buy the latest gadget as soon as you receive a big check from a client. With budgetary restraint, you can earmark the funds for necessary expenses.

♦ **Plan for the future.** Once you become adept at pinpointing business patterns through your budget, it will become easier to plan long-term growth and development. Again, use a healthy dose of caution: It is better to be conservative than to make projections your company simply will not attain.

♦ **Get started now.** Although it takes time to develop a detailed budget, roughing out a rudimentary version is generally better than having no budget at all. If you wait until another year rolls around to take this approach, it may be too late.

***Last but not least**: Do not hesitate to seek outside assistance. You can rely on professional advisers to help create a budget for your particular business.*

Tax Outlook Under New Casualty Loss Rules

New law includes significant modifications

The Emergency Economic Stabilization Act of 2008 includes several important tax law modifications for casualty and theft losses. Significantly, the new law increases the deduction floor for 2009 while providing a special tax break for victims in disaster areas.

Starting point: The tax regulations say that you can qualify for a casualty loss deduction if damage is caused by an event that is "sudden, unexpected or unusual." This includes not only natural disasters such as tornadoes, hurricanes and earthquakes, but also automobile collisions and frozen pipes bursting. The same basic rules apply to theft of your property.

The amount you can deduct each year depends on whether the property damaged is personal or business property. For personal property, the deduction on a 2008 return is limited to the excess above 10% of your adjusted gross income (AGI) after subtracting a $100 "floor" per casualty or theft event. For example, if your AGI for 2008 was $100,000 and you suffered a $20,000 loss to personal property last year, the deduction is limited to $9,900 ([$20,000 – $100] – [10% of $100,000]).

In contrast, there are no such limits for business property. The full amount of the eligible loss can be deducted on the company's return.

The amount that is eligible for the deduction is the lesser of (1) the difference in the property's value before and after the casualty or (2) the adjusted basis in the property.

Of course, you must reduce the deductible amount by any insurance proceeds received.

Finally, there is a special tax break if a loss is suffered in an area designated as a federal disaster area. You can elect to claim the deductible loss on your tax return for the year prior to the year in which the loss occurred.

New rules: The floor for each casualty and theft loss is increased from $100 to $500, but for 2009 only. Going back to our previous example, your deduction would be reduced to $9,500 for a $20,000 casualty loss occurring in 2009.

On the other hand, the new law completely eliminates the 10%-of-AGI limit for losses in federal disaster areas. Thus, if you suffer a $20,000 loss in a disaster area in 2009, you would be able to deduct $19,500 ($20,000 – $500), no matter what your AGI is. The change is effective for tax years beginning after 2007 and before 2010.

Furthermore, the new law allows nonitemizers to deduct personal casualty losses in disaster areas, in addition to claiming the usual standard deduction. This change applies to tax years beginning after 2007.

***Reminder**: Make sure you claim the maximum tax deduction you are entitled to when you file your 2008 return. Professional tax assistance is recommended.*

Dip in the Standard Mileage Rate

The IRS increased the standard mileage rate in the middle of last year. Now it has found a middle ground.

The standard mileage rate may be used in lieu of deducting actual business-related expenses of a vehicle. It was 50.5 cents per business mile traveled (plus related tolls and parking fees) for the first six months of 2008. Then the IRS raised the rate to 58.5 cents for the last six months. The IRS recently announced that this figure has declined to 55 cents per business mile for 2009.

Note: Even if you use the standard mileage rate, you still must keep records showing the date, place, mileage and business purpose of all your trips.

Should You Convert to a Roth IRA Now?

Weigh the benefit against future tax break

There's a big tax break looming next year if you want to convert a traditional IRA into a Roth IRA. But you might not want to wait that long.

Basic rules: As with a traditional IRA, you may contribute up to $5,000 to a Roth IRA (less any traditional IRA contributions) for 2008. An extra $1,000 "catch-up contribution" is allowed if you are 50 years of age or older. There is no current income tax on any earnings within the Roth IRA. The deadline for 2008 contributions is your tax return due date (i.e., April 15, 2009).

However, you cannot take advantage of a Roth IRA if your modified adjusted gross income (AGI) exceeds a certain level. For instance, the phaseout for the 2008 tax year occurs between $159,000 and $169,000 of modified AGI for joint filers, and $101,000 and $116,000 for single filers.

Significantly, qualified distributions from Roth IRAs are exempt from income tax. A qualified distribution is a distribution from a Roth IRA in existence at least five years made

- after age 59½,
- upon death or disability, or
- to pay for first-time homebuyer expenses (up to a lifetime limit of $10,000).

If distributions do not meet these requirements, the funds are treated as being withdrawn as follows: contributions first, any amount converted from a traditional IRA second and earnings third. Withdrawals made before age 59½ may also be subject to a 10% penalty.

Fortunately, you can choose to convert a traditional IRA to a Roth IRA to secure future tax-free distributions. Of course, you must pay the resulting tax on the conversion. This option is only available to individuals who have an AGI of $100,000 or less.

Key tax break: Beginning in 2010, the $100,000 AGI cap for Roth IRA conversions is removed. Furthermore, for conversions taking place in 2010, you may elect to spread the resulting tax liability ratably over the following two years.

So why would you accelerate a conversion? If you believe your IRA assets are currently valued on the low side, you might opt for a conversion if you are below the $100,000 AGI level for 2009. This reduces your tax liability on the conversion. Similarly, if you converted within the past year and the value of the assets has declined since then, you can elect to "undo" the conversion. Otherwise, you will have paid tax on the conversion when the assets were at a higher value.

The decision to convert to a Roth IRA—and when—is complex. Obtain professional assistance for your situation.

Facts and Figures

Timely points of particular interest

➡**Required Minimum Distributions**—Generally, taxpayers 70½ years of age or older must take "required minimum distributions" from IRAs and qualified retirement plans such as 401(k)s each year. However, a new law passed late last year—the Worker, Retiree and Employer Recovery Act of 2008—suspends this requirement for 2009. More related information will be forthcoming.

➡**Student Loans**—In a new case, a lender discharged $3,000 of a consolidated student loan because the borrower had made timely payments for three consecutive years. But the waiver did not qualify as a tax-free gift, nor did the borrower qualify for any special tax law exception. **Result**: The Tax Court said the $3,000 forgiveness of debt constituted taxable income.

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