

## 2008 YEAR END TAX PLANNING

As the end of the year approaches, it is a good time to think of planning moves that will help lower your tax bill this year and possibly the next. Factors that compound the challenge include the stock market's swift decline, the difficult economic climate we're in right now, and the strong possibility that there will be tax changes in the works next year. In fact, there might even be another economic stimulus package carrying tax changes enacted before the end of this year or by early 2009.

The good news we are certain of is that Congress has acted to "patch" the AMT problem for 2008, has retroactively reinstated a number of tax breaks (such as the option to deduct state and local general sales tax instead of state and local income tax and the above-the-line deduction for higher education expenses), and has created new tax breaks that go into effect for the 2008 tax year (including a tax credit for first-time homebuyers, a non-itemizers' deduction for state and local property tax and a non-itemizers' deduction for certain disaster losses). For 2008, businesses enjoy tax breaks such as a beefed-up expensing option and a 50% bonus first-year depreciation write-off for most machinery and equipment placed into service this year and a reinstated research credit.

Below are the items Congress has "fixed" so to speak for 2008 and, in some instances, for 2009:

The recently enacted Emergency Economic Stabilization Act of 2008, otherwise often referred to as the "bailout bill," contains scores of tax changes, mostly beneficial, for individuals and businesses alike. The 2008 checklist points toward the end of this discussion include the effect of some of these changes:

**AMT relief:** In general terms, to find out if you owe alternative minimum tax (AMT), you start with regular taxable income, modify it with various adjustments and preferences (such as add-backs for property and income tax deductions and dependency exemptions), and then subtract an exemption amount (which phases out at higher levels of income). The result is multiplied by an AMT tax rate of 26% or 28% to arrive at the tentative minimum tax. You pay the AMT only if the tentative minimum tax exceeds your regular tax bill. Although it was originally enacted to make sure that wealthy individuals did not escape paying taxes, the AMT has wound up ensnaring many middle-income taxpayers. One reason is that many of the tax figures (such as the tax brackets, standard deductions, and personal exemptions) used to arrive at your regular tax bill are adjusted for inflation, but the tax figures used to arrive at the AMT are not.

For 2008 only, the new law provides some relief. It increases the maximum AMT exemption amount over its 2007 level by \$3,700 for married taxpayers filing joint returns, and by \$1,850 for unmarried individuals and married persons filing separately. However, after 2008 the maximum AMT exemption amount will drop precipitously to where it was in the year 2000 unless Congress provides yet another fix.

Another provision in the new law provides AMT relief for those individuals claiming certain "nonrefundable" personal tax credits (such as the credit for dependent care and the

Scholarship and Lifetime Learning credits). For 2008, these credits may offset an individual's regular tax and AMT. *After 2008, unless Congress acts, these credits will be allowed only to the extent that an individual has regular income tax liability in excess of the tentative minimum tax.*

The new law also liberalized the AMT refundable credit amount that was first enacted in 2006 to help taxpayers who were stung by the AMT as a result of exercising incentive stock options (ISOs). The changes are highly technical but their essence is that for tax years beginning after 2007: (1) eligible individuals may claim this credit more rapidly (i.e., over fewer years) than would have been the case without the change; and (2) the AMT refundable credit amount no longer phases out at higher levels of adjusted gross income (AGI). In addition, the new law wipes out any tax underpayments (plus interest & penalties) outstanding on Oct. 3, 2008, that are attributable to pre-2008 phantom ISO income under the AMT rules.

***Retroactively resuscitated and extended tax breaks:*** All of the following tax breaks had expired at the end of last year. The new law retroactively resuscitates them so that they apply for 2008, and also extends them for one year so that they will apply for 2009 as well:

- The option to claim an itemized deduction for state and local general sales taxes instead of the itemized deduction for state and local income taxes.
- The above-the-line deduction for qualified tuition and related expenses for higher education paid during the tax year.
- The up-to-\$250 eligible educator's above-the-line deduction for books, supplies, computer equipment, etc., used by him or her in the classroom.
- The up-to-\$100,000 annual exclusion from gross income for taxpayers age 70 1/2 or older who make direct transfers of otherwise taxable individual retirement account (IRA) distributions to qualified charitable organizations.

The new law also extends for one year the non-itemizers' additional standard deduction for State and local property taxes paid. The deduction can't exceed the lesser of state and local property taxes actually paid or \$500 (\$1,000 for joint return filers). This deduction was supposed to have been available only for 2008, but the new law makes it available for 2009 as well.

***Deductions for energy saving home improvements extended and expanded:*** Two tax credits are available for taxpayers who make energy saving improvements to residences. They've both been extended by the new law and expanded as well:

(1) A generous tax credit is available to individuals who add solar energy equipment or fuel-cell equipment (new technology that converts fuel into electricity using electromechanical methods, and meets other detailed requirements) to their residences. The new law extends this credit through 2016. It also liberalizes the credit in an important way: For 2008, you can claim a tax credit of 30% of the cost of equipment that uses solar energy to generate electricity (photovoltaic property), up to a \$2,000 maximum tax credit. After 2008, there's no dollar limitation on the credit. For example, suppose you spend \$8,000 buying and installing solar heating panels on your residence. If you make the improvement this year, you may claim a maximum credit of \$2,000, but if you make the improvement next year, you may claim a credit of \$2,400 (30% of \$8,000).

Additionally, starting with 2008, the new law makes the credit available for more-exotic energy generating/retaining equipment: wind turbines; and geothermal heat pumps.

(2) For equipment installed before 2008, you could claim a credit for the cost of buying an assortment of energy saving improvements and installing them in your main home. The credit depends on the type of improvement (e.g., 10% of the cost of energy efficient building envelope components, such as insulation and windows, and an up to \$150 credit for a natural gas, propane, or oil furnace or hot water boiler) and there's an overall \$500 lifetime dollar limit for all improvements.

The new law does *not* extend this credit for qualifying equipment bought and installed in 2008, but it *does* make it available once again for qualifying equipment bought and installed in 2009. Also, for 2009, the new law makes the credit available for certain types of energy efficient biomass fuel stoves and certain types of energy saving asphalt roofs.

***New tax relief for victims of federally declared disasters:*** Individuals may deduct personal casualty losses (e.g., unreimbursed damage to a car due to a storm) or personal theft losses only if they exceed a \$100 limit per casualty or theft and only to the extent these losses in the aggregate exceed 10% of adjusted gross income (AGI). If the disaster occurs in a Presidentially declared disaster area, an individual may elect to take into account the casualty loss in the year immediately preceding the year in which the disaster occurs. Before 2008, only itemizers could deduct casualty losses.

The new law waives the 10%-of-AGI limit for victims of disasters declared to be federal disasters in 2008 and 2009, plus, for these years, permits non-itemizers to claim a deduction for federal disaster losses. However, for 2009 only, the new law boosts the \$100 per casualty limit to \$500 (which will have the effect of reducing deductions).

The new law also gives a number of extra tax breaks to victims of the storms and hurricanes that pummeled ten Midwest states during 2008.

***More detailed reporting of securities transactions – after 2010:*** Stock brokers must file an information return (Form 1099-B) for securities transactions they handle. Currently, brokers report the name and address of the customer, when the sale took place, what was sold, and the gross proceeds of the sale. Starting with stocks (as well as bonds and several other financial instruments) bought after 2010 (a later date applies to some specialized securities), brokers will have to report the customer's adjusted basis (essentially cost for tax purposes) and whether a gain or loss on the transaction was short- or long-term. This new information reporting requirement is designed to boost IRS's compliance efforts (e.g., help assure taxpayers properly report their gains and losses).

### ***Checklist***

Given the above changes and other continuing tax laws in effect, we have compiled a checklist of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

### *Steps you can take before 2009:*

- If your employer sponsors a health flexible spending account (FSA), increase the amount you set aside for next year in your FSA account if you had set aside too little for this year. Don't forget you can set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.
- If you become eligible to make health savings account (HSA) contributions in December of this year, you can make a full year's worth of deductible HSA contributions for 2008.
- Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.
- Postpone income until 2009 and accelerate deductions into 2008 to lower your 2008 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2008 that are phased out over varying levels of adjusted gross income (AGI). These include IRA and Roth IRA contributions, conversions of regular IRAs to Roth IRAs, child credits, higher education tax credits, the above-the-line deduction for higher-education expenses, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. *Note, however, that in some cases, it may pay to actually accelerate income into 2008.* For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year *or if tax rates are expected to rise next year.*
- If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into Roth IRAs if eligible to do so. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2008.
- It may be advantageous to try to arrange with your employer to defer a bonus that may be coming your way until 2009.
- If you own an interest in a partnership or S corporation which has incurred losses over several years, you may need to increase your basis in the entity so you can deduct a loss from it for this year.
- Consider using a credit card to prepay expenses that can generate deductions for this year but postpone payments until next year.
- If you expect to owe state and local income taxes when you file your return next year, ask your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2008.
- If you think you might have under paid estimated tax for 2008 and could face a penalty for underpayment, you may be able to eliminate or reduce it by increasing your withholding.
- You may be able to save taxes this year and next by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.

- Estimate the effect of any year-end planning moves on the alternative minimum tax (AMT) for 2008, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. This includes the deduction for state property taxes on your residence, state income taxes (or state sales tax if you elect this deduction option), miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes. As a result, in some cases, deductions should be deferred rather than accelerated to keep them from being lost because of the AMT. (See the discussion of above of AMT changes enacted recently.)
- If you are thinking of making energy saving improvements to your home, such as putting in extra insulation or installing energy saving windows, postpone your move until 2009. A credit of up to \$500 may be available for such improvements if made next year (but not this year).
- Substantial tax credits are available for installing energy generating equipment (such as solar electric panels or solar hot water heaters) to your home. The credits are available whether you spend the money this year or next, but if you're installing solar electric property, and will be spending more than \$6,667, the credit will be larger for expenses made in 2009 rather than 2008.
- If you are thinking of buying a hybrid vehicle eligible for a tax credit, check to see if it's eligible for the credit, and, if so, purchase it before year-end. Note that for many previously popular hybrids, the tax credits have diminished or vanished based on the number of vehicles previously sold. Some newer hybrids, such as from US manufacturers, still may have higher tax credits available.
- You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.
- Businesses should consider making expenditures that qualify for the up to \$250,000 business property expensing option for assets bought and placed in service this year; the maximum expensing amount will drop to \$133,000 for assets bought and placed in service next year (higher expensing amounts apply to certain specialized assets). Businesses also should consider making expenditures that qualify for 50% bonus first year depreciation if bought and placed in service this year. This bonus write-off generally won't be available next year (some exceptions apply, such as for businesses affected by federally declared disasters).
- You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.
- If you are self-employed and haven't done so yet, set up a self-employed retirement plan.
- You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. You can give \$12,000 in 2008 to an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. The exclusion for 2009 will be \$13,000.
- If you're thinking of donating a used auto to charity, you may want to inquire whether the charity plans to sell the car or use it in its charitable activities; the latter may yield a bigger deduction for you.

- If you are age 70 1/2 or older, own IRAs (or Roth IRAs), and are thinking of making a charitable gift before year-end, consider arranging for the gift to be made directly by the IRA trustee. Such a transfer can achieve important tax savings.
- If you are receiving Social Security benefits, there are a number of steps you can take to reduce or eliminate tax on your benefits.
- Consider extending your subscriptions to professional journals, paying union or professional dues, enrolling in (and paying tuition for) job-related courses, etc., to bunch into 2008 miscellaneous itemized deductions subject to the 2%-of-AGI floor.
- Depending on your particular situation, you may also want to consider deferring a debt-cancellation event until 2009, electing to deduct investment interest against capital gains, and disposing of a passive activity to allow you to deduct suspended losses.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

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