YEAR-END 2008
Volume XXVII | Number 3

TAX TIPS & news

This Issue Includes:

- Tax Calendar
- Breaking News: Congress Extends Tax Benefits Set to Expire
- IRS Expects the Rebate Amount on 2008 Returns
- Year-End Tax Tips and Planning Strategies
- Non-Itemizers Get a Real Property Tax Deduction
- Buying Your First Home? Take Advantage of the New Tax Credit
- A New Twist for Home Sales
- Since You Asked...

Breaking News: Congress Extends Tax Benefits Set to Expire

A number of tax provisions included in the recently enacted Economic Stability legislation will affect just about everyone. The following is an overview of those provisions.

Alternative Minimum Tax Relief – For yet another year, Congress has applied a patch to the AMT by increasing the AMT exemption amount and continuing to allow nonrefundable credits, such as dependent care, child credit, education credits and others that most middle-income taxpayers use to avoid this punitive tax. In addition, the amount of long-term unused AMT tax credit that can be applied in the current year was also substantially increased.

Extended Tax Provisions – Some key taxpayer benefits that had expired have been retroactively reinstated for 2008 and extended through 2009. They include: (1) the tax deduction for state and local sales tax, (2) the teacher's (K through grade 12) above-the-line deduction for expenses, (3) the above-the-line deduction for qualified tuition and (4) the provision that permits taxpayers age 70½ and over to make direct tax-free nondeductible distributions, up to $100,000, from their IRA account to a charity. The tax-free IRA distribution can be very beneficial to taxpayers who have social security income and/or do not itemize their deductions.

Home Energy Efficient Credit – This credit for energy-efficient property installed on the taxpayer's principal residence that originally expired in 2007 has been reinstated for 2009 only. This provision allows a nonrefundable $500 credit for the installation of qualified windows, skylights, air circulation systems, hot water boilers and other energy-efficient equipment.

Residential Energy-Efficient Property (REEP) Credit – This credit, which was scheduled to expire after 2008, has been extended through 2016 and includes credit for the installation of solar water heating systems (excluding swimming pools) and qualified fuel cell property. The $2,000 cap on the solar systems credit is removed as of 2009, wind property and geothermal heat pumps are eligible as of 2008, and the credit can now be claimed against the AMT.

If you have questions relating to any of the reinstated benefits, please give this office a call.

IRS Expects the Rebate Amount on 2008 Returns

The Stimulus Rebate payment that was issued by the Treasury Department earlier this year was actually an advance payment of a new credit called the Recovery Rebate Credit on your 2008 tax return. This credit can be as much as $600 for single taxpayers and $1,200 for joint return filers plus $300 for each qualifying child. Congress required the IRS to use a taxpayer's 2007 tax return information to estimate the credit and issue the advance payment to stimulate the economy. This means that the rebate amount will have to be accounted for on the taxpayer's 2008 tax return with the following results:

- If the rebate amount was less than the credit computed on the taxpayer's 2008 return, the additional amount will be credited to the 2008 return.
- If the rebate amount was more than the credit computed on the taxpayer's 2008 return, the difference will not have to be repaid.
- If the taxpayer did not receive a rebate, he or she will receive the full amount of the credit on the 2008 return to the extent that he or she qualifies for the credit.

(Continued on next page...)

Year-End Tax Tips and Planning Strategies

The end of the year is traditionally a time to celebrate the holidays, and your 2008 taxes may be the farthest thing from your mind. However, with a few exceptions, it is your last opportunity to alter the results of your 2008 taxes. The following are some of the many possible strategies that can be employed before year's end.

Required Minimum Distributions (RMD) – If you are 70 1/2 or older, make sure that the minimum distribution amount is withdrawn from your IRA or other qualified plans to avoid the 50% penalty for under-withdrawals.

IRA and Qualified Plan Withdrawals – If you are retired and taking IRA distributions, make sure that you are maximizing your withdrawal with respect to your tax bracket. It may be tax-effective to actually withdraw more than the minimum required by law. If you receive Social Security benefits, IRA distributions can sometimes be planned to minimize the taxability of this income.

Avoid Underpayment Penalties – Taxpayers are expected to pay their taxes during the year through withholding and/or the payment of estimated taxes. If you have not paid enough and do not meet one of the exceptions, you could be subject to an underpayment penalty, along with an unpleasant tax bill when the tax return is filed. Year-end increased withholding and estimates can mitigate those penalties.

Capital Gains and Losses – If you have any capital gains or losses from sales of stock or other capital assets, or you have stock or other capital assets that are ripe for sale, it may be advisable to meet and discuss how you can best coordinate timing your gains and losses to minimize tax on your gains and maximize the tax benefit from your losses.

Zero Tax Rate – If you or a family member are thinking of selling appreciated stock or other capital assets, and your (or their) income isn't taxed at a rate higher than 15%, you can take advantage of the zero tax rate available in 2008.

Expecting a Year-End Bonus – It may be advantageous to arrange with your employer to defer a bonus until after the end of the year, thereby deferring the taxes on it until 2009.

Fuel-Efficient Vehicle – If you are thinking of buying a hybrid or advanced lean-burn vehicle eligible for a tax credit (1), be sure to confirm that the particular model still qualifies for the credit.

(IRS Expects the Rebate Amount on 2008 Returns Cont'd…)

Some taxpayers qualify for this credit even though they are not required to file a tax return. However, to receive the rebate credit, a return must be filed. To qualify, a taxpayer must have at least $3,000 of qualifying income, which generally includes earned income (wages, salaries, self-employment income, etc.), Social Security benefits and certain disability benefits, or have a net tax liability greater than zero and gross income greater than the sum of the standard deduction and exemption amounts on the tax return.

The amount of a taxpayer's adjusted gross income (AGI) affects the amount of the credit. When AGI is over $75,000 ($150,000 for married couples who file jointly), the credit is phased out by 5% of the income above the AGI thresholds. Taxpayers who did not receive the full rebate payment in 2007 because of the AGI limitation may be eligible to receive the difference as a credit on their 2008 returns, depending on the amount of their 2008 AGI.

If you did not receive a rebate payment during 2007, it may have been because the rebates were subject to offsets for any federal debts owed, including back taxes, unpaid child support, or federal student loans. Even if you did not receive a cash payment because of one of these offsets, you must still treat the rebate as if you had received the cash when accounting for it on your 2008 return. Please call if you have questions regarding the rebate payment.

Bunch Deductions – If you are marginally able to itemize each year, it may be appropriate to "bunch" deductions in one year and then claim the standard deduction in the alternate year.

State Estimated Tax Payments – Although the deadline for most states is January 15, 2009, for the fourth quarter 2008 state estimated tax payment, if that payment is made before the end of December 2008, the payment will count as a tax deduction (1) on federal Schedule A for 2008.

Property Taxes – Generally, your property taxes (1) are billed in installments, and that is how most people pay them. However, the tax can be paid all at once if it provides a greater tax benefit for the current year.

Charitable Contributions – If you have been planning to contribute used clothing and household goods to a charity, doing so before the year's end can increase your itemized deductions. But keep in mind that under the stringent rules for charitable donations, the items must generally be in good or better condition, and your contribution will need to be substantiated.

Annual Gift Tax Exclusion – 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.

Roth IRA Conversions – If your taxable income is low or a negative amount for the year, it may be appropriate to convert some or all of your taxable traditional IRA to a Roth IRA for little or no tax cost. Roth IRAs provide the benefit of tax-free income for retirement.

Education Credits – If you qualify for one of the higher education tax credits and have not paid enough tuition during the year to achieve the maximum credit, the law allows you to prepay tuition for an academic period beginning within the first three months of the next year and claim the tuition for the current year's credit.

If you would like to discuss other possible strategies or how any of the ones listed above apply to you, please call this office.

(1) **Caution:** These credits and/or deductions do not benefit taxpayers who are subject to the alternative minimum tax (AMT).

Non-Itemizers Get a Real Property Tax Deduction

New for 2008 and 2009, taxpayers who do not itemize can add to their standard deduction the cost of their real property taxes, not to exceed $500 ($1,000 for taxpayers filing jointly).

Those who stand to benefit from this provision are taxpayers who pay property taxes but whose itemized deductions are less than the standard deduction. This most frequently will include retired taxpayers who have paid off their home loans and do not have any mortgage interest to deduct. Note that to the extent any real estate taxes are related to business property, such as a home office, and deducted elsewhere on the tax return, they cannot be included in the added standard deduction.

Take, for example, a retired married couple, both over age 65, who paid $2,500 in property taxes and have no other significant itemized deductions. Prior to this law change, their 2008 standard deduction would have been $13,000 (the $10,900 basic amount for joint filers plus $2,100 as an additional amount for married couples both over 65). With the added real property tax deduction, the couple's standard deduction is increased by the lesser of their property taxes or $1,000. Therefore, for 2008, their standard deduction will be $14,000. Assuming that they are in the 15% tax bracket, this will save them $150 of federal income tax.

In actual application, some taxpayers who are marginally itemizing their deductions may find it beneficial to take the standard deduction. Please call this office if you have any questions.

Buying Your First Home? Take Advantage of the New Tax Credit

Now may be a good time to purchase a home, since there are a lot of good deals awaiting those with a down payment to facilitate a purchase. Congress has come up with a novel way to help first-time homebuyers afford the down payment on a home.

For home purchases made after April 8, 2008, and before July 1, 2009, a first-time homebuyer can receive a refundable tax credit equal to 10% of the purchase price of the home but capped at $7,500 ($3,750 for married taxpayers filing separately).

But before you get too excited, you should know that the credit is essentially an interest-free loan that must be paid back over a 15-year period. Installments equal to 6.67% of the amount of the original credit in the form of an additional tax amount on the homeowner's federal tax returns. If the home is sold or no longer used as a primary residence before the end of the 15-year period, the balance of the credit that has not been repaid must be repaid in the year it is no longer the taxpayer's primary residence. However, the credit repayment amount cannot exceed the gain from the sale of the residence to an unrelated person, and no repayment is required in a year after the death of the taxpayer.

A first-time homebuyer is a taxpayer (or spouse if married) who had no present ownership interest in a principal residence in the U.S. during the 3-year period before the purchase of the home to which the credit applies.

To make sure this credit is not used by wealthy taxpayers, the credit is phased out for individual taxpayers with incomes between $75,000 and $95,000 and for jointly-filing taxpayers with incomes between $150,000 and $170,000.

Taxpayers with a purchase in 2009 that qualifies for the credit can elect to claim the credit on their 2008 tax return and not have to wait until 2010 when they file their 2009 return to get the credit.

The credit is not allowed for nonresident alien taxpayers, homes that are financed with tax-exempt mortgage bonds, or property purchased from a related party. There are also special rules to deal with divorce, casualty losses, involuntary conversions, etc.

If you would like to take advantage of this opportunity and see how this credit will help your unique situation, please call to schedule a planning appointment.

A New Twist for Home Sales

With the advent of the home sale gain exclusion back in the 1990s, taxpayers have been using that provision of the law in a popular strategy to exclude gain, not just from their primary residence but from rentals and second homes as well.

They do that by moving into and making the rental or second home their primary residence for two years, then selling it and excluding the gain, up to $250,000 ($500,000 for joint filers).

To qualify for the exclusion, each taxpayer must own and occupy the home as his primary residence for two of the five years prior to the sale and not utilize the exclusion in the two years immediately preceding the sale. Thus, with careful planning, taxpayers could employ this technique on multiple properties.

Apparently, this strategy became too popular, and Congress included a provision in the recently enacted Housing Assistance Act of 2008 to curtail gain exclusion attributable to periods of ownership when the property was not the taxpayer's primary residence. The new law accomplishes this by prorating the home sale gain between qualified and nonqualifed use periods and allowing the home gain exclusion to apply only to gain from qualified periods.

The law does provide a taxpayer beneficial definition of nonqualified use. A period of nonqualified use means any period during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence, except as noted below. For purposes of determining periods of nonqualified use, do not include any period:

- Before January 1, 2009;
- After the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period); and
- Not to exceed two years that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

If your planning strategies include employing multiple sales, each qualifying for the home sale exclusion, you should carefully analyze the impact of this new law on your plans.

NOVEMBER 08-APRIL 09

Tax Calendar

November-December 2008: It's time for 2008 year-end and 2009 tax planning, especially if you have substantial increases in income or fewer deductions. Please call for an appointment.

December 31, 2008:

- This is the last day to pay deductible expenses for the 2008 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2008.
- This is the last day to make the minimum required withdrawal of funds from a traditional IRA account and avoid a penalty if you turned age 70 1/2 before 2008.
- This is the last day to set up a Keogh retirement account if you plan to make a 2008 contribution.

January 15, 2009:
The fourth quarter 2008 federal estimated tax payment is due unless the 2008 return is filed by February 2, 2009. **Caution:** Some states may have different filing dates for state estimated payments.

February 2, 2009: This is the deadline for providing 1099s and W-2s to those people you paid during 2008. If you are a business or rental property owner that paid $600 or more for the services of individuals (other than employees) during the year, you will need to provide 1099s to those workers by this date. "Services" can mean everything from labor and professional fees to rents on property. The normal due date is January 31, but because it falls on a weekend, the due date is the next business day.

March 2, 2009: This is the deadline for filing (sending) 1099s and W-2s to the government. The normal due date is February 28, but because it falls on a weekend, the due date is the next business day.

April 1, 2009: This is the last day to withdraw funds from your traditional IRA if you turned age 70 1/2 in 2008 and haven't taken your 2008 distribution yet. In addition, this is the last day to withdraw funds from a SEP or Keogh plan for individuals who are retired and turned age 70 1/2 in 2008. Failure to take the required distributions can result in substantial penalties.

April 15, 2009:

- This is the deadline for individuals to file a 2008 federal return or request an extension of time to file.
- The first installment of the 2009 federal estimated tax payment is due.
- The first installment of the 2009 defined benefit pension plan contributions are due.

TAX TIPS & news

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

Since You **Asked...**

You Asked: My wife is handicapped and I am considering making some improvements to our home to make it easier for her to get around in the home. Is there a tax deduction for such home modifications?

Answer: Generally, home improvements are not deductible except to offset home gain when the home is sold. But a medical expense deduction may be claimed if you make a medically-necessary home improvement, such as a lift or elevator for a handicapped person, or a therapy spa for an arthritis sufferer. The cost of such an expense is deductible as a medical expense to the extent it exceeds any resulting increase in the value of the property. For example, if a qualifying improvement costing $5,000 increases the value of your home by $2,000, the medical expense is $3,000. The full cost of certain improvements can be included as medical expenses, because they are considered not to increase the home's value. Examples of these types of improvements include constructing entrance or exit ramps for the home; widening entrance/exit doorways, hallways and interior doorways; installing railings and support bars; and lowering or modifying kitchen cabinets. Note, however, that medical expenses can be claimed on Schedule A, Form 1040, only to the extent that they exceed 7.5% of your adjusted gross income (10% if you are taxed by the AMT).

You Asked: Even though I was not experiencing any symptoms of illness, I had a full-body scan done as a precaution. I paid for it out-of-pocket and was wondering if it would be deductible for tax purposes.

Answer: The answer is yes. The IRS, in a recent notice (Rev Rul 2007-72), ruled that several medical procedures are deductible even though the individual was not experiencing any symptoms of illness. It included an annual physical examination, self-administered pregnancy tests, and a full-body scan even though a physician had not recommended it. Keep in mind that you can only deduct medical expenses in excess of 7.5% of your adjusted gross income (10% if you are taxed by the AMT).