



Newsletter

TAX TIPS

Mid-Year Tax Planning

The Reardon Group of Companies:
Weiss + Reardon & Company, P.C.
Audit, Accounting, Tax & Compliance
Reardon Consulting, Inc.
Healthcare, Financial & Management Consulting
Valuation Advisors, Inc.
*Valuations for Practice Mergers & Acquisitions,
Estate & Gift Taxes and Litigation Services*

From Gregory T. Reardon, Managing Shareholder

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To Our Clients and Friends:

Although this year is only about half over, we've already had three new tax laws with several more almost certainly on the way. Despite added confusion created by these repetitive changes, the current federal income tax environment is still quite favorable. Now is the time to take advantage of the tax breaks that Congress has provided before they are taken away. This letter presents some tax planning ideas to consider this summer while you have time to think. Some of the ideas may apply to you, some to family members, and others to your business.

Consider Deferring Income

It may also pay to defer taxable income from this year to next year, especially if you expect to be in a lower tax bracket in 2009. For example, if you're in business or a professional practice for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out certain invoices. That way, you won't receive payment for them until early 2009. You can also postpone taxable income by prepaying some deductible business expenses before the end of this year. Both moves will defer taxable income from this year until next year.

Deferring income may also be helpful if you're affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (such as itemized deductions, the child tax credit, the education tax credits, and so forth). By deferring income every other year, you may be able to increase your eligibility for these tax breaks every other year.

Caveat: Depending on the outcome of the November elections, high-income taxpayers (those with taxable incomes exceeding around \$250,000) stand a good chance of seeing higher regular income tax rates in 2009. If that becomes the case, it may pay to accelerate income from 2009 into 2008.

Time Investment Gains and Losses

As you evaluate investments held in your taxable accounts, consider the impact of selling some appreciated securities, especially those you've held for over a year that would generate long-term capital gains. The maximum federal income tax rate on most long-term capital gains from 2008 sales is only 15%. Therefore, now may be a good time to cash in some long-term winners to benefit from historically low tax rates. Cashing in some winners this year could turn out to be a really smart move if tax rates go up next year. Depending on how the November elections turn out, higher capital gains taxes in 2009 are a definite possibility.

Selling some loser securities (currently worth less than you paid for them) before year-end can be a good idea too. The resulting capital losses will offset capital gains from other sales this year (including short-term gains from securities owned for one year or less). If capital losses exceed capital gains, the excess losses can be used to shelter up to \$3,000 of your high-taxed ordinary income from salaries, bonuses, self-employment, and so forth (\$1,500 if you're married and file separately). However, depending on your exact situation, you could actually collect greater tax savings by triggering capital losses during a year in which you have minimal or no long-term gains. That could be next year rather than this year, especially given this year's low capital gains tax rates.

Contact us if you want help in identifying your best tax-smart options.

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Take Advantage of 0% Rate before It's Too Late

For 2008, the federal income tax rate on long-term capital gains and qualified dividends is 0% when they fall within the 10% or 15% regular federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed \$65,100 if you're married and file jointly (\$32,550 if you're single).

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in one of the bottom two tax brackets for 2008. If so, consider giving them some appreciated stock or mutual fund shares which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day. Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

While the 0% rate is scheduled to be available through 2010, things could change as early as next year depending on how the elections turn out. So consider doing what you need to do to take advantage this year. Next year could be too late.

Warning No. 1: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting investment income to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.

Warning No. 2: Be aware that if you give away assets worth over \$12,000 during 2008 to an individual gift recipient, it will generally eat into your \$1 million lifetime federal gift tax exemption and your federal estate tax exemption (\$2 million for 2008; \$3.5 million for 2009). However, you and your spouse can together give away up to \$24,000 without any adverse effects on your respective gift and estate tax exemptions.

2008 May Be a Good Year for Dividends, Stock Redemptions, and Stock Sales

If you're a shareholder in a closely held C corporation, the current federal income tax rate structure is helpful to your cause. If the company pays you a taxable dividend, the maximum federal rate is only 15%. The same 15% maximum rate applies to corporate payouts and stock sales that generate long-term capital gains. Better yet, as we just discussed, if the stockholder's (you or perhaps a child to whom you've given stock) taxable income is low enough there won't be any tax at all on this income assuming Kiddie tax doesn't come into play. Because this taxpayer-friendly scenario could change, now may be a good time to convert some of your C corporation wealth into cash at a very manageable tax cost (and possibly none at all). Here's why we say that.

Higher tax rates on dividends and long-term gains are scheduled to kick in starting with 2011. The maximum federal rate on dividends will jump from the current 15% to a whopping 39.6%, and the maximum rate on most long-term gains will jump from the current 15% to 20%. While 2011 may seem to be in the distant future, we could see those higher tax rates (or even worse) as early as next year—depending on how the November elections turn out. To hedge against that possibility, consider the following ideas.

- *Take Dividends in 2008.* They will be taxed at a federal rate of no more than 15%. If you wait, dividends in future years could be taxed at 39.6% (or maybe even higher) depending on how the political winds blow.
- *Do Stock Redemption Deal in 2008.* Depending on the exact circumstances, payments from your corporation to redeem (buy back) some or all of your shares will generally be treated as either taxable dividends or as proceeds from selling your shares (i.e., garden-variety stock sale treatment). Redemption payments treated as 2008 dividends will be taxed at a maximum federal rate of no more than 15%. To the extent redemption payments treated as 2008 stock sale proceeds trigger long-term capital gains, they will also be taxed at no more than 15%. If you wait, you run the risk of paying a 39.6% federal rate (or maybe even higher) on

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redemption payments treated as dividends and a 20% rate (or maybe even higher) on redemption payments that trigger long-term capital gains.

- *Sell Stock in 2008.* Speaking strictly from a tax-rate perspective, selling shares in 2008 and paying a federal rate of no more than 15% (for shares held over one year) beats paying a 20% rate (or maybe even higher) on gains from sales in future years.

Observation: These strategies are based on speculation about future tax rate hikes that may or may not occur. Also, there may be other more beneficial tax strategies for you and your corporation. Contact us for more information.

Take Advantage of Generous but Temporary Tax Breaks

Several taxpayer-friendly changes kicked in this year. They include the following.

- *Bigger Section 179 Deduction.* Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2008, the maximum Section 179 deduction is a whopping \$250,000. For tax years beginning in 2009, however, the maximum deduction is scheduled to drop back to about \$130,000 (depending on the inflation adjustment). Various limitations apply to the Section 179 deduction privilege, so please contact us if you want more information.
- *50% First-year Bonus Depreciation.* Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software acquired and placed in service by December 31 of this year. The 50% first-year bonus depreciation break will expire at year-end unless Congress takes further action. Contact us if you want more details about this generous, but temporary, tax break.
- *Qualified Conservation Donations.* Congress just extended rules that allow extra-favorable tax treatment for qualified conservation contributions by individuals and farm businesses to charitable organizations. These rules are now available for contributions in tax years beginning 2008 and 2009.
- *Economic Stimulus Rebates.* The government has already issued economic stimulus rebate payments to millions of individuals. The payments can range from \$300 to \$1,200 or more for those with children. Rebate amounts are based on information reported on your 2007 individual federal income tax return. You (or a loved one) may qualify for a rebate even though you are not required to file a 2007 return because you had only a modest amount of income last year. However, anyone who wants to collect a rebate in 2008 must file a 2007 Form 1040 or Form 1040A. No return, no rebate, no exceptions! Contact us if you have questions about filing a return to collect a rebate.

Watch for the Alternative Minimum Tax

While many recent tax-law changes have been helpful in reducing your regular federal income tax bill, they didn't do much to reduce the odds that you'll owe the dreaded alternative minimum tax (AMT). Therefore, it's critical to evaluate all tax planning strategies in light of the AMT rules before actually making any moves. Because the AMT rules are complicated (and because they will probably be changed again for the 2008 tax year), you may want our assistance. We stand ready to help!

Don't Forget about Your Estate

The federal estate tax exemption for 2008 is \$2 million. For 2009, the exemption is scheduled to increase to \$3.5 million. For 2010, the federal estate tax is supposed to be repealed—but just for that one year. It now seems clear that if the promised repeal ever happens at all, it will just be for 2010. The more likely scenario is that we will continue to have a federal estate tax for 2010 and beyond, but possibly (hopefully) with a somewhat larger

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exemption than the current \$2 million figure. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan.

Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you can give each of them up to \$12,000 this year. So can your spouse. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So the sooner you start an annual gifting program, the better. Contact us for more information on the best ways to avoid estate taxes for someone in your situation.

Conclusion

As we said at the beginning, this letter is intended to give you just a few ideas to get you thinking about tax planning for 2008. ***Please don't hesitate to contact us if you want more details or would like to schedule a tax planning strategy session. We are at your service!***

Best regards,

Weiss + Reardon & Company, P.C.



Gregory T. Reardon
Managing Shareholder

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