# Newsletter

## TAX TIPS

## Year-End Tax Planning

**The Reardon Group of Companies:**
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**From Gregory T. Reardon, Managing Shareholder**
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To Our Clients and Friends,

As we approach year-end, it's again time to focus on a few December last-minute moves you can make to save taxes—both on your 2008 return and in future years. Before we get started, however, it's worth a reminder that the purpose of the ideas we'll discuss in the following paragraphs is limited to achieving your personal and business financial objectives in a "tax efficient" manner. In other words, a proposed transaction normally should not only save taxes, but also make economic sense before it's a wise move. In addition, it's generally best to look at your tax situation for at least two years at a time, with the objective of reducing your tax liability for both years combined, not just for 2008.

In the interest of time, to expedite getting this to you as soon as possible we are forwarding this tax planner to you via e-mail. If you wish to have a copy in hard print, please call our office and we will gladly mail you a printed version!

### AMT Makes It a Whole New Ball Game

Individuals must compute their income taxes under two systems—the regular tax system and the so-called alternative minimum tax (AMT) system—and pay the higher of the two amounts. When introduced many years ago, the AMT targeted and normally only applied to high-income taxpayers who, in Congress' opinion, benefited too much from certain tax breaks. Today, however, virtually no taxpayer can ignore the AMT. Therefore, the first step in tax planning is to assess your exposure to AMT. Tax planning for AMT is often dramatically different than planning for regular tax. In fact, it's sometimes backwards.

Who is at the highest risk for AMT? Many taxpayers can fall into AMT, but those who deduct a significant amount of state and local taxes or miscellaneous itemized deductions (like unreimbursed employee business expenses) or claim multiple dependents are especially vulnerable. Those who recognize a large capital gain or exercise incentive stock options during the year are also vulnerable. If you suspect AMT might be an issue, please contact us so we can plan accordingly. Regrettably, most of our clients remain AMT vulnerable despite the changes reflected in the massive Emergency Economic Stabilization Act of 2008 which was rushed into law this past October 3rd. For instance, this change in the new law expanded the AMT exemption up to $69,950 if you are a married joint-filer or a surviving spouse (up from $66,250 for 2007). Unfortunately, these exemptions remain subject to phase-outs for higher income taxpayers, so if you fell subject to AMT in 2007, you will most likely fall prey to it in 2008 as well! Many of the new legislation changes will impact your 2009 tax planning more than 2008 (as the new legislation extended many of the tax breaks slated to expire). Thus, since this focus is for 2008, and we know you don't want this to read like a book, we will limit our comments to what you might be able to do this tax year 2008 and leave 2009 alone for now. We all clearly expect to see more massive reforms to be proposed for 2009 and beyond as the president-elect and the new congress try to grapple with our current economic crisis.

Now that we've addressed the AMT, let's move on to a variety of tax planning strategies that apply to the vast majority of taxpayers—that is, those in a regular tax situation.

### Consider Deferring Income and Accelerating Deductions

Due to the time value of money, it's better to pay taxes later rather than sooner (assuming your tax rates won't be appreciably higher next year). Therefore, strategies that defer income from the current year to later years and

those that move deductions from later years into the current year are always popular. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2009. You can also postpone taxable income by prepaying a reasonable amount of deductible business expenses such as office supplies and repairs and maintenance before the end of this year. Both moves will defer taxable income from this year until next year.

You might also consider moving charitable donations you normally would make in early 2009 to the end of 2008. If you're temporarily short on cash, charge the contribution to a credit card—it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or state income taxes otherwise due in early 2008. But, watch out for the AMT, as these taxes are not deductible for AMT purposes.

**Caveat:** Depending on the political and economic climate, high-income taxpayers (those with taxable incomes exceeding around $250,000) may well see higher regular income tax rates in 2009. If so, it may pay to accelerate (rather than to defer) income and defer (rather than accelerate) deductions from 2009 into 2008. Please give us a call if this applies to you.

## Charitable Giving Strategies

**Documentation Is Key.** Charitable contributions are only deductible if you have proper documentation. For cash contributions of less than $250, this means you must obtain either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets tax-law requirements. For cash donations of $250 or more, a bank record is not enough. You must obtain, by the time your tax return is filed, a charity-provided statement that lists any significant goods or services received in return for the donation (other than intangible religious benefits) or specifically states that you received no goods or services from the charity.

**Charitable Gifts of Stock.** If you are one of the few fortunate taxpayers who may have appreciated stock that you've held more than a year, and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no load mutual funds because there are no transaction fees involved.)

However, if the stock is now worth less than you when you acquired it (perhaps more the case than not), sell the stock, take the loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value and no capital loss will be available. Also, if you sell the stock at a loss, you can't immediately buy back a like number of shares as this will trigger the wash sale rules, which means your loss won't be deductible, but instead will be added to the basis in the new shares.

## Investment Strategies

**Harvesting Capital Losses.** There's no question that this has been a horrendous year for the stock market. It's likely that you are sitting on some investments that have dropped in value since you acquired them. If it otherwise makes sense, now might be a good time to dump part or all of them to cut your tax bill. You can deduct capital losses up to the amount of any capital gains that you'll have for the year (for example, from mutual fund distributions or sales of stocks or bonds). Also, you can claim up to an additional $3,000 of losses ($1,500 if you're married but filing a separate return) against your other income. Any losses in excess of these amounts carry over to next year.

If you're selling less than your entire interest in an investment, you can maximize the amount of deductible loss that you realize by telling your broker or mutual fund company to sell the highest basis shares first (and then have them confirm your instructions in writing within a reasonable time after the sale). In addition, if you think your investments that are currently underwater are poised for a comeback, you can buy them back after taking a loss as long as you don't reacquire them within 30 days before *or* after the sale.

**Timing Long-term Capital Gains.** Despite the down market, you hopefully still own some appreciated investments in your taxable accounts. If so, you may want to consider selling any that 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. This could turn out to be a really smart move if capital gains tax rates go up next year—a definite possibility.

Of course, investment moves should not be made solely to capitalize on the current low capital gains rates, but if you're planning to sell sometime in the near future, sooner may be better than later. For example, now may be a good time to diversify a large holding of stock you've held for over a year. The stock's value may be down, but that is also true of most other securities. Selling now could save big tax dollars (due not only to the low capital gains rate but also because of the depressed sales price). Your investment dollars could then go to scooping up other securities at depressed prices.

**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 can. 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 is over a year. 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. 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 per recipient without any adverse effects on your respective gift and estate tax exemptions.

## Ideas for Your Business

The IRS has released on its website various final forms, schedules and instructions for the 2008 tax year that pertain to self-employed individuals. The 2008 instructions for Schedule C list several new items under the heading "What's New". Here are some selected items that may impact your 2008 tax plans:

### Schedule C, Profit or Loss from Business (Sole Proprietorship)

**Consider Paying a Dividend in 2008.** 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%. 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. However, this will likely change in the near future, so 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). The maximum federal rate on dividends is scheduled to jump from the current 15% to a whopping 39.6% starting with 2011. 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 the economy and political winds. However, don't lose sight of the C Corporation income tax on Personal Service Corporations (doctors, lawyers, accountants, engineers, etc.), if you are a significant owner or sole owner in such a Personal Service C Corporation, the tax at the corporation level starts at 35% Federal and may well outstrip any potential tax savings. Typically, only entities that are regular C Corporations (and not a Personal Service C corporation) can benefit from such a strategy. Call us before you act!

**Take Advantage of Temporary Tax Breaks for Equipment and Software Purchases**. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property, you might consider doing so before year-end to maximize your 2008 deductions. Here's why:

- *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. However, the allowable deduction cannot exceed your business's net income and is reduced dollar-for-dollar to the extent the amount of qualifying property placed in service during the year exceeds $800,000. For tax years beginning in 2009, the maximum deduction is estimated to drop back to about $133,000, with reductions estimated to begin when more than $530,000 of qualifying property is placed in service.
- *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 (reduced by the Section 179 deduction) 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 these generous, but temporary, tax breaks.

**Avoid the Hobby Loss Rules.** A lot of businesses that are just starting out or have hit a bump in the road wind up showing a loss for the year. The last thing the business owner wants in this situation is for the IRS to come knocking on the door arguing the business' losses aren't deductible because the activity is just a hobby for the owner. Surprisingly, the IRS has been fairly successful recently in making this argument when it takes taxpayers to court. Thus, if your business is expecting a loss this year, we should talk before year-end to make sure we do everything possible to maximize the tax benefit of the loss and minimize its economic impact.

**Schedule SE, Self-Employment Tax**

- Cap on social security tax. The maximum amount of self-employment income subject to social security tax is $102,000.

Optional methods to figure net earnings. As discussed in more detail below, beginning after December 31, 2007, the amount of gross and net income from self-employment you may have when using the farm optional method or nonfarm optional method has increased. This allows electing taxpayers to secure up to four credits of social security benefits coverage. In future years, the thresholds will be indexed to maintain this level of coverage. The reason for this is a result of a law change optional methods of computing self-employment earnings now referred to as the "lower limit" or "upper limit". The "lower limit" for any tax year is the sum of the amounts required under Sec. 213(d) of the Social Security Act for a quarter of coverage in effect with respect to each calendar quarter ending with or within that tax year. (Code Sec. 1402(1)(1). Thus, for 2008, it is $4,200 ($1,050 x 4) and for 2009 it is $4,360 ($1,090 x 4). The "upper limit is 150% of the lower limit. (Code Sec. 1402(1)(2).Apart from giving an individual credit toward their social security coverage even though they had a loss or a small amount of income from self-employment, using an optional method may enable an individual to claim or obtain a large earned income credit, child tax credit, and/or child or dependent care credit.

Nonfarm optional method. An individual may be able to use this method to figure their net earnings form nonfarm self-employment if their net nonfarm profits were less than $4,548 and also less than 72.189% of their gross nonfarm income. Net nonfarm profits are the total of the amounts from:

- Schedule C (Form 1040), line 31
- Schedule C-EZ (Form 1040), line 3
- Schedule K-1 (Form 1065), box 14, code A (from other than farm partnerships), and
- Schedule K-1 (Form 1065-B), box 9, code J1.

To use this method, the taxpayer also must be regularly self-employed. This requirement is met if their actual net earnings from self-employment were $400 or more in 2 of the 3 years preceding the year they use the nonfarm optional method. The net earnings of $400 or more could be from either farm or nonfarm earnings or both. The net earnings include the taxpayer's distributive share of partnership income or loss subject to SE tax.

Use of the nonfarm optional method from nonfarm self-employment is limited to 5 years. The 5 years do not have to be consecutive.

Under this method, an individual reports in Part II, Line 17, two-thirds of their gross nonfarm income, up to $4,200, as their net earnings, but cannot report less than the actual net earnings from nonfarm self-employment.

**Tax Planning at the Office**

**401(k) Plans.** If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

**Cafeteria Plan Flexible Spending Accounts (FSAs).** If your company has an FSA, before year-end you must specify how much of your 2009 salary you wish to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying child care costs. One word of caution, though, FSAs are "use-it-or-lose-it" accounts. Thus, you don't want to set aside more in such an account than what you'll likely have in qualifying expenses for the year.

Married couples who both have access to an FSA will also need to decide whose FSA to use. If one spouse's salary is likely to be higher than what's known as the FICA wage limit (which is $102,000 for this year and will be somewhat higher next year) and the other spouse's will be less, the one with the smaller salary should fund as much of the couple's FSA needs as possible. The reason is the 6.2% social security tax levy stops at the FICA wage limit (and doesn't apply at all to money put into an FSA). Thus, for example, if one spouse earns $110,000 and the other $40,000 and they want to collectively set aside $5,000 in their FSAs, they can save $310 (6.2% of $5,000) by having the full amount taken from the lower-paid spouse's salary versus having 100% taken from the other one's wages. Of course, either way, the couple will also save approximately $1,500 in income and Medicare taxes because of the FSA.

Last but not least, if you currently have an FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: over-the-counter drugs (e.g., aspirin and antacids), new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early.

**Adjusting Federal Income Tax Withholding.** If it looks like you are going to owe income taxes for 2008, consider bumping up the Federal income taxes withheld from your paychecks now through the end of the year so that your total tax payments (estimated payments plus withholdings) equal at least 90% of your estimated 2008 liability or, if smaller, 100% of last year's liability (110% if your 2007 adjusted gross income exceeded $150,000, $75,000 for married individuals who filed separate returns). When you file your return, you will still have to pay the taxes due less the amount paid in, but interest or penalties will be minimized, if not eliminated.

**Retirement Planning**

**Make Your 2008 IRA Contributions.** Don't forget to make your 2008 traditional or Roth IRA contributions as soon as possible, but definitely before the due date (4/15/09) of your tax return. Except in the case of the Roth IRA, the earnings in retirement accounts are technically tax-deferred, not tax-free. However, funding them as soon as possible allows you to defer more taxes for 2008. Thus, you benefit by keeping more funds invested for a longer period of time.

For 2008, combined Roth and traditional IRA contributions generally can be made up to the lesser of (1) $5,000 ($6,000 if age 50 or older by the end of 2008) or (2) 100% of compensation. Compensation includes wages, salaries, other amounts derived from or received for personal services actually rendered including self-employment income, and alimony. For married couples, IRA contributions up to $5,000 ($6,000 if age 50 or older by the end of 2008) can be made for each spouse if the combined compensation of both spouses is at least equal to the contributed amount and they file a joint return (even if one spouse earned all the income).

If neither you nor your spouse (if you're married) are active participants in an employer-maintained retirement plan, traditional IRA contributions are fully deductible. Otherwise, the amount of the traditional IRA contribution that is deductible will be limited when your AGI exceeds certain limits.

Roth IRA contributions are never deductible. Nevertheless, it's hard to beat a Roth IRA because of the availability of tax-free distributions if you satisfy certain conditions, the lack of mandatory distributions at age 70½, and the

option of withdrawing your contributions tax-free and penalty-free at any time. Unfortunately, Roth IRA contributions are not allowed once your AGI exceeds $169,000 if you're married and file jointly or $116,000 if you're not married. If you have earned income, but don't qualify for a Roth IRA or a deductible traditional IRA, you may still want to make a nondeductible contribution to a traditional IRA to take advantage of the tax deferred growth such accounts provide. Also, starting in 2010, all taxpayers will have the option of converting their traditional IRAs to Roth IRAs. (Currently only taxpayers with AGI of $100,000 or less can convert a traditional IRA to a Roth IRA.)

**Required Distributions for Taxpayers Age 70 ½ and Older.** If you're age 70½ or older, you're normally subject to the so-called minimum distribution rules with regard to your retirement plans (other than Roth IRAs). Under these rules, you must receive at least a certain amount each year from your retirement accounts. You can always take out more than the required amount, but anything less is subject to a 50% penalty on the shortfall amount.

If you turned age 70½ in 2008, you can delay your 2008 required distribution to 2009 if you choose. But, waiting until 2009 will result in two distributions in 2009—the amount required for 2008 plus the amount required for 2009. While deferring income is normally a sound tax strategy, here it results in bunching income into 2009. Thus, think twice before delaying your 2008 distribution to 2009—bunching income into 2009 might throw you into a higher tax bracket or have a detrimental impact on your tax deductions.

## 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 with a $3.5 million or somewhat larger exemption. 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 and your spouse both can give each of them up to $12,000 this year. 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

With a little effort and some careful planning, it's possible your 2008 tax liability can still be significantly reduced. We're available to assist you in this planning process any way we can. Please don't hesitate to contact us with questions or ideas on reducing your tax bill. If we haven't heard from you in a couple of weeks, we'll give you a call to see if you'd like to set up an appointment.

Best regards,

***Weiss + Reardon & Company, P.C.***

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