TAX NEWSLETTER

2008 YEAR END TAX PLANNING

NOVEMBER 19, 2008

Dear Clients and Other Friends,

You probably chuckled a bit when you saw the title of this newsletter. Some people feel you only need to tax plan in the high income years and this year definitely will not qualify as a high income year for some of you. However, there are many ways to take tax advantage of the lower income years. Also, there are still many of you who have had successful years and need to do the "normal" year end tax planning. I will address both sides of the equations in this newsletter.

Making the best of the bad:

<u>Zero Capital Gains Tax:</u> yes, it is possible to pay zero tax on long-term capital gains and qualified dividends. This assumes, of course, you can find some assets that you can sell for a gain. . If your taxable income excluding your long-term capital gains and qualified dividends (ATI) is below $65,100 for a joint return or $32,550 for a single return then you will pay zero tax on the amount of long-term gains and dividends up to the difference between the ATI and $65,100 or $32,500. *Example:* You have taxable income of $80,000 including long-term capital gain of $70,000; ATI would be $10,000 ($80,000-$70,000). Amount of capital gain taxed at zero for a joint return would be $55,100 ($65,100 - $10,000). Amount of capital gain taxed at 15% would be $14,900 ($70,000 - $55,100).

<u>Convert IRAs to Roth IRA</u>: For many people it is more beneficial to have a Roth IRA than a traditional IRA. This may be the year to convert some of your traditional IRAs to a Roth. First, you can only convert in a year that your adjusted gross income will not exceed $100,000. So, if your income is down this year it may be the year to convert. Second, since you are taxed on the value of the IRA when you convert it to the Roth, and for most people their IRAs are worth much less than they were, this would be a cheaper year to convert. In other words, when the value recovers, it will recover in the tax free Roth. Third, if you do have a low income year you will be paying tax on the converted amount at a lower rate. This will raise your income, so take that into consideration when balancing this decision with other tax planning moves.

<u>Re-characterizing an earlier Roth conversion</u>: If you converted a traditional IRA to a Roth early in 2008 only to watch the value drop later in the year, you may want to convert it back to a traditional IRA. Otherwise you will be paying tax on value that has evaporated. You have until the due date of your 2008 return, including extensions, to do this re-characterization.

<u>Using Capital Losses</u>: I am sure your financial advisors have advised you to take advantage of the losses in your portfolio to realign some of your holdings. In addition, after you have netted all of your capital gains with your capital losses, you can use $3000 of the excess loss to offset ordinary income. Any additional loss will be carried over to future years.

<u>Offsetting Mutual Funds Capital Gains</u>: I have read where many mutual funds will be reporting large capital gains to their investors. If you are in this situation, you may want to sell some of your "loss" stock to have losses to offset the gain. However, consider the zero tax discussed above.

<u>Moving Income into this Year, Deductions into Next Year</u>: The traditional tax planning is to accelerate deductions into the current year and delay income into next year. If you expect next year to be better than this year, you may want to reverse this traditional thinking.

T.J. JACOBSEN, CPA
PO BOX 10900, BAINBRIDGE ISLAND, WA 98110
(206) 842-8200 (206) 842-8207 fax email@tjjcpa.com www.tjjcpa.com

Making the best of the good:

Maximize Deductions: Make sure you have maximized your contributions to your Heath Savings Account (HSA). The maximum is $5,800 for family coverage and $2,900 for single coverage, plus another $900 if you are 55 or over.

IRA: You have until April 15th to decide on your IRA contribution. So, you do not need to make a decision on this before the end of the year. The maximum deduction this year is $5,000 plus another $1,000 if you are 50 or over.

Retirement Plans: If you have a business you have many more options for making retirement contributions. A simple SEP plan can be set up as late as the extended filing date of your return and allows you to put away up to 25% of your business income. If you want to put away even more, then you might want to set up a 401k plan. This could allow you to sock away the 25% of your business income (like a SEP) plus another $16,500 for the 401k deferral. If you are 50 or over, you can put in another $5,000 as a catch-up contribution. However, the 401k must be established before the end of the year, and you need to make the deferral and catch-up portion of the contribution by the end of the year. You have until the filing date of the return to contribute the "25%". Also, there are many other considerations which are beyond the scope of this newsletter, so contact me if this is of interest to you.

Some general thoughts:

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you 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.
- 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.
- If you own an interest in a partnership or S corporation 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.
- Those facing a penalty for underpayment of federal estimated tax may be able to eliminate or reduce it by increasing their 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 sales tax, 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.
- 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. At this point most dealers consider any car leaving the lot to be a hybrid…….

- 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 presidentially declared disasters).
- 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.
- 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 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.

Tax planning for the future:
I think it is safe to say, and remain politically correct, that we are in for considerable change in our tax laws. One of the advantages of being in the tax business is I win, even when my candidate loses. Every change of administration results in new tax laws, especially when accompanied by a change in control of the legislative branches. The state of our economy will prevent wholesale tax increases at least for awhile. However, I believe we will start to see some changes almost immediately. I will be here to help you sort them all out – for a fee of course…..

Hopefully you will find some of these ideas helpful. Please contact me if you have any questions.

Tim

Disclaimer: By nature of a newsletter, this information is in summary form and does not necessarily detail every requirement, restriction or tax planning opportunity. Prior to executing any tax strategy, you should consider non-tax implications - you may cost yourself more than you save in taxes. Please use this information with these limitations in mind. If you are considering executing a particular tax strategy, please contact me so we can discuss the specifics.

Any tax advice in this communication is not intended to be a "covered opinion." Therefore this communication cannot be used by any party to avoid penalties which may be imposed by the Internal Revenue Service.