YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

It's once again time for year-end tax planning. This year, planning requires us to navigate through a host of new tax changes. For 2008, we have witnessed new tax legislation at an unprecedented pace. In the last 12 months, Congress has enacted no less than six separate tax bills. For example, on October 3, 2008, President Bush signed the "Emergency Economic Stabilization Act of 2008" which not only extended a variety of popular tax breaks that had expired in 2007, but also contained several new tax relief provisions. Collectively, these recent tax bills contain major changes including several temporary economic stimulus provisions such as a new refundable first-time home-buyer credit, a new individual tax rebate/credit, and an enhanced refundable child credit. In addition, 2008 is the first year we can take advantage of several other new tax breaks, including: a new additional standard deduction for real property taxes, expanded alternative minimum tax (AMT) relief for incentive stock options (ISOs) and AMT credit carry forwards, and a zero-percent capital gains tax. As 2008 is rapidly coming to a close, time to take advantage of these tax breaks is growing short.

We are sending you this letter to bring you up-to-date on these and other *new* tax planning opportunities for individual taxpayers. We also want to remind you of the *traditional* year-end tax planning strategies that **1)** help ensure your income is taxed at the lowest possible rate, and **2)** will postpone taxes by deferring your taxable income and accelerating your deductions.

Be Careful! Moving income from one tax year to another may reduce your personal exemptions and itemized deductions. Moreover, strategies suggested in this letter may subject you to AMT. For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Also, AMT can be unexpectedly triggered by taking large capital gains or exercising incentive stock options. Therefore, **we suggest that you call our firm before implementing any tax planning technique discussed in this letter.** You cannot properly evaluate a particular planning strategy without calculating your overall tax with and without that strategy.

Please Note! This letter contains ideas for Federal income tax planning only. State income tax issues are **not** addressed.

RECENT LEGISLATION IMPACTING YEAR-END PLANNING

Since late December, 2007, President Bush has signed into law the following six tax bills:

1) Mortgage Forgiveness Debt Relief Act of 2007 (*2007 Debt Relief Act*)
2) Economic Stimulus Act of 2008 (*2008 Stimulus Act*)
3) Heartland, Habitat, Harvest, and Horticulture Act of 2008 (*2008 Farm Act*)
4) Heroes Earnings and Relief Tax Act of 2008 (*2008 Heroes Act*)
5) Housing Assistance Tax Act of 2008 (*2008 Housing Act*)
6) Emergency Economic Stabilization Act of 2008 (*2008 Stabilization Act*)

Collectively these tax bills include: an extension of previously-expired tax breaks; tax relief for homeowners and home buyers; a tax rebate/credit to help stimulate the economy; alternative minimum tax relief, and tax relief to military members and their families. These new tax provisions will impact virtually every individual taxpayer. As you read the following highlights, please keep in mind that there are several tax breaks available **only in 2008**, other long-term changes are **first effective in 2008**, while some changes are not effective until later. Consequently, pay careful attention to the **effective date** and **expiration date** (if applicable) for each new provision which we **highlight prominently** in each segment.

There Is Some Bad News Too! Although most of these tax changes benefit taxpayers, not all of the news is good. Congress has also imposed several new restrictions and limitations on individual taxpayers, including a new restriction on the home-sale gain exclusion rule and a potential tax on U.S. citizens who move their citizenship abroad (expatriates) or receive gifts from expatriates. These new restrictions are also highlighted below.

The following summarizes *selected* provisions that we think will have the greatest impact on year-end planning for individual taxpayers.

Expired Tax Breaks Extended. A long list of popular tax breaks for individual taxpayers was scheduled to expire at the end of 2007. The *2008 Stabilization Act* postponed the expiration dates for many of these provisions, as follows:

***Selected* Expiring Tax Provisions Extended Through The End Of 2009: 1)** School Teachers' Deduction (Up to $250) for Certain School Supplies; **2)** Deduction for State and Local Sales Tax; **3)** Deduction (up to $4,000) for Qualified Higher Education Expenses; **4)** New Real Property Tax Standard Deduction For Non Itemizers, **5)** Qualifying Tax-Free Transfers from IRAs to Charities for Those at Least 70; and **6)** Increased Charitable Deduction Limits for Qualifying Conservation Easements. **<u>Planning Alert!</u>** Under the technical language of the *2008 Stabilization Act*, the $500 credit for Energy-Efficient Home Improvements is available for 2007 and 2009, **but not for 2008.**

Alternative Minimum Tax (AMT) Relief Extended Through 2008. Without the *2008 Stabilization Act*, you would have received an AMT exemption of only $33,750 (individuals) and $45,000 (married filing jointly) for 2008, and there would have been no AMT offset for many personal tax credits. If these exemptions had not been increased to reflect 2008 inflation rates, IRS says the number of taxpayers paying AMT in 2008 would have increased from approximately 4 million to 25 million. The *2008 Stabilization Act* increased the AMT exemption amounts **for 2008 only** to **$46,200** (individuals) and **$69,950** (married filing jointly). The Act also

extended **for 2008 only** the ability to use certain personal credits (including the dependent care, elderly and disabled, HOPE, Lifetime Learning, and D.C. home buyer credits) against the AMT. **Planning Alert!** The items that commonly trigger AMT for individual taxpayers include: high state and local taxes, an unusually large number of dependents, large medical expenses, or the exercise of an incentive stock option. If you anticipate having significant amounts of any of these items, contacting us early will increase our chances of helping you minimize your AMT for 2008.

Refundable AMT Credit. Many companies offer tax-favored incentive stock options (ISOs) as compensation. Under the *regular tax rules,* ISOs are not taxed upon exercise. Under the *AMT rules*, however, upon exercise, a taxpayer must include the excess of the stock value over the exercise price in income. The economic downturn in 2000 resulted in many individuals having to pay tax on "phantom income" because the stock prices dropped dramatically after the date of exercise. Starting in 2007, Congress provided relief for these and other AMT situations. Subject to certain income phase-out thresholds, the 2007 law created a new *refundable* AMT credit for any "long-term unused AMT credit" (i.e., an AMT credit generated more than 3 years prior to the current year). So, to have *a long-term unused AMT credit* for 2008, it must have been generated **in years prior to 2005.**

Previously, this refundable AMT credit was generally recovered 20% per year (stretching it over a 5-year period). **For tax years 2008 through 2012,** the *2008 Stabilization Act*: **1)** generally allows 50% of *long-term unused AMT credits* to be used over each of 2 years (instead of 20% over each of 5 years), **2)** eliminates the income phase-out altogether, **3)** increases your *long-term unused AMT credit* by any interest and penalty you **paid before October 3, 2008** on AMT attributable to ISO income, and **4)** completely abates any AMT *attributable to the exercise of ISOs* **for any tax year ending before 2008** that remains outstanding **on October 3, 2008**, including interest and penalties. **Planning Alert!** Although the new 2-year refund period and the elimination of the income thresholds apply to all long-term unused AMT credits, the tax abatement provision described above (item 3) applies **only** to those AMT credits that arose from exercising ISOs. **Tax Tip.** This new provision is great news if you exercised ISOs before 2008 and failed to pay the resulting AMT liability (or the applicable interest and/or penalties) by October 3, 2008. You are now completely relieved of this liability. Also, if you have paid AMT in the past (or you previously paid interest and/or penalties on AMT triggered by an ISO), you may qualify for a refundable AMT credit for **2008 and 2009** that could actually generate a cash refund to you. Remember, with this new law change, you can qualify for this AMT relief regardless of your income level.

Existing AMT Rules For Exercising ISOs Continue To Apply. Going forward, the *2008 Stabilization Act* does not eliminate the current AMT impact of exercising ISOs. **Planning Alert!** Exercising an ISO in 2008 could still generate a 2008 AMT if the difference between the stock's value and the exercise price is substantial. **Tax Tip.** If you exercised an ISO **in 2008** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2008 AMT tax liability if you sell the stock **on or before December 31, 2008.** Please check with us if you have exercised incentive stock options during 2008 and the price of the stock has fallen since the date of exercise. A sale of the stock after December 31, 2008 will not affect your AMT liability for 2008. So, we must act timely for a sale to reduce 2008 taxes!

New Temporary First-Time Home-Buyer Credit (With Pay-Back Requirement).

The *2008 Housing Act* adds a new temporary refundable credit of up to $7,500 (whether filing jointly or single) for qualified first-time home buyers who buy the house **after April 8, 2008 and before July 1, 2009.** The

purchase (i.e., title closing) of your first-time home after April 8, 2008 will qualify even if you signed the purchase contract before April 9, 2008. The amount of the credit is the lesser of: **1)** $7,500 ($3,750 if you are married filing separately), or **2)** 10% of the home's purchase price. The credit is phased out as your adjusted gross income (AGI) increases from $75,000 to $95,000 if you are single, or from $150,000 to $170,000 if you are married filing jointly. Since the credit is refundable, you will actually get a refund to the extent the credit exceeds your tax liability. However, unlike most refundable credits that you can keep, this credit has an automatic 15-year payback requirement that resembles an interest-free loan that must be repaid to the government. The following highlights the requirements for this new credit:

Who Qualifies As A First-Time Home Buyer? To qualify as a first-time home buyer, neither you nor your spouse can have owned a principal residence in the U.S. during the 3-year period ending on the date of the purchase of your new principal residence. **Planning Alert!** You will **not qualify** for the credit if you purchase your home from a related party (e.g., certain family members). **Tax Tip.** Your *principal residence* could include a condominium, houseboat, or mobile home.

How Does The 15-Year Pay Back Work? Subject to certain limitations, you must effectively pay back the credit ratably over 15 years by means of an extra tax on your subsequent tax returns, beginning with the second tax year following the tax year in which the home is purchased. Thus, a qualifying first-time home buyer who buys a principal residence in 2008 and claims a $7,500 credit, will pay the credit back annually by adding $500 ($7,500) 15 years) to his or her tax liability starting with the 2010 tax return, and ending with the 2024 tax return.

If I Buy My First Home In 2009, Can I Take The Credit On My 2008 Return? If you purchase your qualifying new residence **after 2008**, and **before July 1, 2009**, you may elect to treat the purchase as made on December 31, 2008. **Tax Tip.** This election is particularly beneficial to college students who graduated in 2008, have income below the income threshold for 2008, and purchase their first home in the first six months of 2009. If the student’s 2009 income exceeds the threshold levels, electing to take the credit on the 2008 return will salvage the credit.

New Real Property Tax Deduction For Non-Itemizers.

For **2008 and 2009 only**, if you do not itemize your deductions (i.e., you take the standard deduction), you may claim an *additional* standard deduction for any state and local property taxes you pay. Your deduction, however, is limited to $500 ($1,000 in the case of a joint return), or the actual real estate taxes you paid, if less. **Planning Alert!** If you are a homeowner and you itemize your deductions on your 2008 return, this new provision will not benefit you. However, if you plan to take the standard deduction for 2008, to get the full $1,000 additional standard deduction (on a joint return), you must pay at least $1,000 of property taxes for 2008. If you are sitting on a property tax bill that will help you meet the $1,000 cap ($500 if single), be sure that you pay it **before the end of 2008. Tax Tip.** This new deduction is available regardless of your income level.

Enhanced Refundable Child Tax Credit (For 2008 Only).

If your income does not exceed certain thresholds, you may be entitled to a $1,000 child tax credit even if the credit exceeds your Federal income tax liability. **For 2007**, you were entitled to this *refundable* credit to the

extent of 15% of your earned income in excess of $11,750. The *2008 Stabilization Act* reduces the earned income threshold **for tax years beginning in 2008** to $8,500. **Planning Alert!** This reduction of the earned income threshold is only for 2008. **Tax Tip.** For 2008, if you have one qualifying child, you need earned income of at least $15,167 (down from $18,417 for 2007) to qualify for the full $1,000 refundable credit.

Requirements For Qualifying Child Tweaked.

For **tax years beginning after 2008**, the *2008 Stabilization Act* makes several changes for a taxpayer to obtain certain tax benefits for a qualifying child (e.g., earned income tax credit, $1,000 child credit, dependency exemption). For example, under the new law, for certain tax benefits, a *qualifying child* must be younger than the claiming taxpayer, and a taxpayer (other than the child's parent) claiming the child must have higher AGI than the parents of the *qualifying child*. **Tax Tip.** These changes will now allow the *earned income tax credit* for a qualifying older sibling who is caring for a younger sibling in a home with no parents, which was denied under prior law due to a technical glitch. **Planning Alert!** These changes will also eliminate the opportunity under prior law for high-income parents with several children to shift tax breaks to one of their lower-income children.

Surviving Spouses Get Home-Sale Exclusion Relief.

You can generally exclude up to $250,000 ($500,000 for joint returns) of gain realized on the sale or exchange of your principal residence that you have used as your principal residence for at least 2 of the previous 5 years. Under prior law, if a spouse died, the surviving spouse could qualify for the $500,000 exclusion only if the sale occurred in the tax year of the deceased spouse's death. Under the *2007 Debt Relief Act*, **effective for sales or exchanges after 2007**, a surviving spouse will be able to use the $500,000 home sale exclusion (rather than the $250,000 exclusion) for **sales occurring within 2 years after the death of a spouse,** provided that **1)** the spouses qualified for the $500,000 exclusion immediately before the death of the deceased spouse, and **2)** the surviving spouse has not remarried by the date of the sale. **Tax Tip.** This new tax break will be most beneficial to a surviving spouse who was the sole owner of the home before the death of the decedent spouse. In that event, the surviving spouse would have received no step-up in basis for the house on the decedent spouse's death and this expanded opportunity for the survivor to qualify for the $500,000 exclusion becomes much more important. This is more common with second marriages where the spouse who owned a house before the marriage continues to be the sole owner after the marriage. **Tax Tip.** Don't forget, if you are a surviving spouse wishing to take advantage of this new tax break, you must sell your house within the 2-year period immediately following the date of the spouse's death.

What Do I Need To Know About The Stimulus Rebate Credit?

By now, the vast majority of qualifying taxpayers have received their government-issued rebate check. Even though this is technically a credit for the 2008 tax year, your rebate was calculated by the IRS based upon your 2007 income tax return information. The rebates were generally $600 for individuals, $1,200 for couples, $300 or $600 for certain low-income people, and an additional $300 for your qualifying dependents under age 17. Even if you otherwise qualify, your rebate credit begins phasing out once your adjusted gross income (AGI) exceeds $75,000 ($150,000 for joint returns). For joint filers with no children, the credit will generally be lost entirely when your AGI reaches $174,000 (single filers with no children will generally lose the entire credit when their AGI reaches $87,000).

In certain situations, the rules for calculating this rebate can be quite complicated. Fortunately, for most individuals who qualify, the IRS has already computed the rebate and sent a check. If you have a question about the computation or status of your rebate check, you can access www.IRS.gov and click on the link that addresses rebates or stimulus payment. **Tax Tip.** If your rebate check turns out to be greater than your actual 2008 credit, you can keep the excess! Also, the IRS says the stimulus payment is not taxable income. **Planning Alert!** You should keep your IRS letter reflecting the amount of the rebate, so we can use it to determine how much to reduce your credit for 2008.

Military Families Can Get The Stimulus Rebate Without Spouse's Social Security Number.

When Congress authorized the economic stimulus payments, it required that no payments could be made to individuals filing joint returns unless each spouse had a valid Social Security number. The *2008 Heroes Act* now provides that a Social Security number is not required for joint returns where **at least one spouse was a member of the U.S. Armed Forces** at any time during the tax year. In addition, a qualifying child is taken into account in determining the amount of the credit even though the return doesn't include the child's Social Security number. **Tax Tip.** This provision is particularly helpful to U.S. Armed Forces members who are married to foreign spouses who lack Social Security numbers.

Military Death Benefits May Now Be Contributed To Roth IRAs, Etc.

Effective for payments made on account of deaths from injuries occurring after October 6, 2001, the *2008 Heroes Act* generally provides that a recipient of a military death gratuity and/or Service Members' Group Life Insurance proceeds can, within certain time limits, contribute the amounts received to a Roth IRA or Coverdell Education Savings Account (CESA). These contributions will not be subject to the regular CESA or Roth IRA contribution limitations nor the AGI phase-out rules. **Tax Tip.** This gives survivors more choices as to where they can invest these benefits.

Home-Sale Exclusion Restricted.

If you sell your home, you may qualify for the home-sale exclusion which allows you to sell your principal residence and exclude the gain up to $250,000 ($500,000 if filing jointly). Generally, to qualify, you must have owned and used the home as your principal residence for at least 2 of the preceding 5 years. Typically, because of the *principal residence* requirement, you cannot exclude any gain from the sale of your vacation or second home. This has led some taxpayers to convert a second home into a principal residence for at least 2 years before selling the home, thus qualifying the home for the full $250,000/$500,000 exclusion. The *2008 Housing Act* clamps down on this planning technique for **sales after 2008** by generally requiring you to pay taxes on the portion of the gain that reflects the time the home was not used as your principal residence. **Good News!** This new restriction is not retroactive. Instead, it applies only to sales after 2008. In addition, any periods of personal or rental use before 2009 **are ignored**. **Tax Tip.** If you currently own a second home or rental home and you convert it to your principal residence before 2009**,** you can generally avoid this new restriction altogether. **Planning Alert!** The actual mechanics for applying this new rule can be complicated. Please call us if you need more information on this new limitation.

PLANNING WITH THE EXPANDED KIDDIE TAX AND THE NEW ZERO % CAPITAL GAINS

Kiddie Tax Expanded Starting In 2008. Before 2008, children under age 18 were taxed on their unearned income (e.g., interest, dividends, and capital gains) at their parents' marginal tax rate if the unearned income exceeded a *threshold amount*. This rule is commonly referred to as the kiddie tax. **Starting in 2008**, the *kiddie tax* has been expanded and becomes more complicated. Under the new rules, a child who *is not filing a joint return with a spouse* will have his or her unearned income in excess of the *threshold amount* ($1,800 for 2008), taxed at the *parents' tax rate* if: **1)**The child either **has not attained age 18** by the *close of the tax year*; **OR 2)**The child **is age 18** by the *close of the tax year* AND the child's **earned income does not exceed one-half the child's support**; **OR 3)**The child is **age 19 through 23** by the *close of the tax year* AND the child is a full-time student AND the child's earned income does not exceed one-half the child's support. **Planning Alert!** Unlike prior years, starting in 2008, many college students will no longer be able to sell off their appreciated capital gain investment accounts set up by their parents to cover tuition and pay tax at the student's lower tax rates. Furthermore, most college students under age 24 will generally be unable to qualify for the new zero % capital gains tax rate discussed below. **Tax Tip.** Since a child's *earned income* is not taxed at the parents' rate, you should consider employing your child in your business and pay your child *reasonable* compensation. Your child's earnings won't be subject to the kiddie tax and will generate a deduction for the family business. Also, if your child is over age 17 and generates earned income exceeding one-half of his or her support, the child could also avoid the kiddie tax exposure.

New Zero % Capital Gains Tax Rate Starts In 2008! Year-end strategies for long-term capital gain and qualified dividend income have historically focused largely on high-bracket investors. However, with 2008 ushering in a *temporary* zero % capital gains tax rate for lower bracket taxpayers, capital gain planning has become particularly urgent for 2008.

How Does The Zero % Rate Work? From 2008 through 2010, the long-term capital gains and qualified dividends that would otherwise be included in the 15% (or below) ordinary income tax bracket, will be taxed at a zero % rate. **Planning Alert!** For 2008, all ordinary income (e.g., W-2, Form 1099, interest income) up to $65,100 for joint returns ($32,550 if single) is taxed at the 15% rate, or below. Thus, taxpayers filing jointly can benefit from the zero percent capital gains rate if (and to the extent) they have 2008 ordinary taxable income under $65,100 ($32,550 if filing single). **Example.** Assume that Betty and Fred **1)** have joint 2008 W-2 income of $75,000 (and no other taxable income), **2)** have two dependent children (each 2008 personal exemption is $3,500), and **3)** use the standard deduction ($10,900 for 2008 joint returns). For 2008, their taxable income is $50,100 ($75,000 minus 4 exemptions which total $14,000, minus the standard deduction of $10,900). Thus, Betty and Fred could generate up to $15,000 ($65,100 minus $50,100) of net long term capital gain taxed at zero %. All net long term capital gain exceeding $15,000 would be taxed at 15%. **Tax Tip.** Formerly high-income taxpayers who are between jobs, are recently retired, or who expect to report higher-than-normal business deductions in 2008, may find themselves in a low enough tax bracket to take advantage of the zero % capital gains rate. If you are experiencing any of these situations, please call our firm and we will help you determine if there is a strategy for you to take advantage of these temporarily low capital gains rates. **Please note** that traditional year-end planning for capital gains and losses is discussed below.

***TRADITIONAL* YEAR-END TAX PLANNING TECHNIQUES**

Planning With Capital Gains And Losses

Year-End Considerations For Capital Assets. Timing your year-end sales of stocks, bonds, or other securities may save you taxes. After fully evaluating the economic factors, the following are several year-end tax planning ideas for sales of capital assets. **Caution!** Always consider the economics of a sale or exchange **first!**

Taking Capital Losses To The Extent Of Capital Gains Plus $3,000. If you have already recognized capital gains in 2008, you should consider selling securities (that have declined in value) **prior to January 1, 2009.** These losses will be deductible on your 2008 return to the extent of your recognized capital gains, plus $3,000. **Tax Tip.** These losses may have the added benefit of reducing your income to a level that you qualify for other tax breaks (e.g., the new $7,500 first-time home-buyer's credit, $600 stimulus refundable credit, $1,000 child credit, HOPE education credit, and IRA contributions). **Planning Alert!** If within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the wash sale rules. If, however, you are caught by this wash sale rule, your disallowed loss will increase the tax basis of your replacement stock, which could reduce the ultimate gain on a subsequent sale of the stock.

Making The Most Of Capital Losses. If your stock sales to date have created a *net* capital loss exceeding $3,000, consider selling enough appreciated securities **before the end of 2008** to decrease the net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your *net* capital loss (in excess of $3,000) to absorb your short-term capital gain, while preserving your favorable long-term capital gain treatment for later years. **Tax Tip.** Net short-term capital gains could also be used to free up a deduction for any investment interest you have incurred (e.g., interest you have paid on your margin account).

Year-End Mutual Fund Purchases. If you are thinking about buying mutual fund shares near year-end, watch out for a common tax trap. Mutual funds typically distribute income, including capital gains, near the end of each year. If you invest in the fund near the end of the year, but on or before the record date for this payout, you generally will be taxed on a year-end distribution as if you had held the fund all year. This, in essence, treats a return of your investment as a taxable distribution. **Tax Tip.** Before investing, determine the amount and timing of any year-end payout.

Stock "Traders" May Save Taxes By Electing "Mark-to-Market. If you are a "trader" (instead of an investor) in stocks, the "mark-to-market" election could possibly save you taxes. Generally, you may qualify as a "trader" if you have frequent purchases and sales of stock, you hold the stock for short-term gain (rather than long-term appreciation and dividends), and you have a high volume of stock transactions for the year. As a trader, you can elect (for tax purposes) to mark your stock down or up to market at year end. This election will convert what would generally be short-term capital gains and losses, into "ordinary" gains and losses. **Tax Tip.** This election could save taxes if at some point you incur significant losses. If you make a timely "mark-to-market election, you can deduct those losses as "ordinary losses," instead of being limited by the $3,000 ceiling on net capital losses. Also, making this election **will not** subject your mark-to-market stock gains to Social Security or Medicare taxes. **Planning Alert!** Unless you made the election for a prior year, the mark-to-market election, unfortunately, must be made by the due date (without regard to extensions) of your **prior year's tax return**. Even though it is too late to make the election for 2008, you may wish to make the election by April 15, 2009,

for 2009 and future years. Please call us if you think this election might save you taxes and we will be glad to fill you in on the details.

Postponing Taxable Income

It is generally a good idea to defer as much income into 2009 as possible if you believe that your marginal tax rate for 2009 will be equal to or less than your 2008 marginal tax rate. Deferring income into 2009 could also increase various credits and deductions for 2008 that are being phased out as your adjusted gross income increases. **Be Careful!** In the current political environment, many are predicting that Congress could increase tax rates on regular income, dividend income, and/or capital gains **as early as 2009.** However, if you believe that deferring taxable income into 2009 will save you taxes, consider the following strategies.

Self-Employed Business Income. If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2009. **Planning Alert!** If you have already received the check in 2008, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Installment Sales. If you plan to sell certain appreciated property in 2008, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify, the gain will be taxed to you as you collect the principal payments on the note. **Planning Alert!** Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe that your chances of getting paid are at risk. **Tax Tip.** The maximum long-term capital gains rate is presently scheduled to increase from 15% to 20% after 2010. This scheduled increase in the long-term capital gains rate should be considered before agreeing to accept an installment note with payments due beyond the 2010 tax year.

Required Distributions From Retirement Plans. If you want to postpone the distributions (and therefore the taxation) of amounts in your traditional IRA or in a qualified retirement plan as long as possible, there are many technical steps you need to consider, including:

Naming A Proper Beneficiary. It is critical that you name the appropriate beneficiaries such as an individual or a qualified trust. **Planning Alert!** If your estate is the beneficiary of your IRA or qualified plan account, your heirs will generally miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a contingent beneficiary in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70.5, your entire retirement account generally must be distributed and taxed within **five years** of the year of your death. This will cause your beneficiaries to lose valuable tax deferral options. **Planning Alert!** The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions **you may need to take before the end of 2008**:

Post Mortem Planning. If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2008, there are certain planning techniques you should consider as soon as possible. **Tax Tip.** If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the

situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2008, the best tax results can generally be achieved by making any necessary changes **no later than December 31, 2008**. If you need assistance, please call our office as soon as possible so we can advise you.

Attaining Age 70.5 During 2008. If you reach age 70.5 at any time during 2008, you must begin distributions from a traditional IRA account no later than April 1, 2009. A 50% penalty applies to the excess of the required minimum distribution over the amount actually distributed. If you wait until 2009 to make the first distribution, then two distributions must be made for 2009 (one by April 1, 2009 for the 2008 year, and one by December 31, 2009 for the 2009 year). If you are in this situation, please call our firm and we will help you determine whether it will be to your tax advantage to defer the required distribution for 2008 until 2009, or make the 2008 distribution **on or before December 31, 2008.**

Rollovers By Surviving Spouses. If a taxpayer over age 70.5 died during 2008 and the beneficiary of the decedent's IRA or qualified plan is the surviving spouse, and the surviving spouse is over 59.5, the surviving spouse should consider rolling the decedent's qualified plan or IRA amount into his or her name **on or before December 31, 2008.** If the decedent's retirement account is rolled into an IRA in the surviving spouse's name before 2009, then **1)** if the surviving spouse is not at least age 70.5, no distributions are required in 2009, and **2)** if the surviving spouse is at least 70.5, the required minimum distribution in 2009 will be determined using the Uniform Lifetime Distribution Table rather than the surviving spouse's single life expectancy. **Therefore, converting the account into the surviving spouse's name on or before December 31, 2008, will substantially reduce the amount of the required minimum distribution for 2009 where the decedent was at least 70.5.** **Planning Alert!** If the surviving spouse is not yet 59.5, leaving the IRA or qualified plan amount in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59.5. If the account is transferred into the spouse's name, and the spouse receives a distribution before reaching age 59.5, the distribution could be subject to a 10% early distribution penalty unless made as a series of payments over the surviving spouse's life expectancy.

Transfers To Non-Spouse Beneficiaries. Many qualified retirement plans require the distribution of amounts in an employee's account within a certain period after the employee's death. If a plan participant dies, recent tax legislation allows us to make a tax-deferred *trustee-to-trustee* transfer from a qualified retirement plan (e.g., a '401(k) plan, a profit-sharing plan) to an IRA for the benefit of a *non-spouse* beneficiary. If the transfer occurs within the time limits discussed below, this new rule will generally allow the non-spouse beneficiary to distribute and pay tax on his or her share of the decedent's account balance over the beneficiary's life expectancy. **Planning Alert!** To qualify, the new IRA must be set up in a manner that makes it clear that it is an inherited IRA (e.g., Tom Smith as beneficiary of John Smith, deceased). **Tax Tip.** To ensure that the inherited IRA will be entitled to pay its account balance over the non-spouse beneficiary's life expectancy without penalty, the direct trustee-to-trustee transfer generally should occur *prior to the end of the year following the year of the employee's death*. **Planning Alert!** If the employee died in 2007, you may need to complete the direct trustee-to-trustee transfer to the non-spouse beneficiary's inherited IRA **no later than December 31, 2008,** to maximize the payout period. Please call our firm if you think that you might benefit from this rule.

Taking Advantage Of Deductions

Accelerating Deductions Into 2008. As a cash method taxpayer, you can generally accelerate a 2009 deduction into 2008 by paying it in 2008. Accelerating an above-the-line deduction, such as the IRA deduction, qualified student loan interest and tuition deductions, qualified moving expenses, and deductible alimony into 2008 may allow you to reduce your adjusted gross income below the thresholds needed to qualify for many other tax benefits. Remember, itemized deductions do not reduce your adjusted gross income and, therefore, will not affect your 2008 deductions and credits that are reduced as your income increases. *Itemized deductions* include charitable contributions, state and local taxes, medical expenses, unreimbursed employee travel expenses, and home mortgage interest. **Tax Tip.** Payment typically occurs in 2008 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, Discovery, American Express) in 2008. **Be careful,** if you post-date the check to 2009 or if your check bounces no payment has been made in 2008. **Planning Alert!** The IRS says that prepayments of expenses applicable to periods beyond 12 months will not be deductible in 2008.

Bunching Itemized Deductions. If your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years. **Tax Tip.** The easiest deductions to shift between tax years are charitable contributions, state and local taxes, and your January home mortgage interest payment. For 2008, the standard deduction is $10,900 on a joint return and $5,450 for single individuals. If you are blind or age 65, you get an additional standard deduction of $1,050 if you're married ($1,350 if single). **Planning Alert!** For 2008, most itemized deductions are reduced by 1% of your adjusted gross income in excess of $159,950 ($79,975 for married individuals filing separately). This cut back is eliminated in 2010.

Bunching Medical Expenses. Many taxpayers ignore the medical expense deduction because medical expenses are deductible only if they exceed 7.5% of your adjusted gross income (10% for AMT purposes). However, if you have medical expenses that are discretionary, you may be able to bunch them into 2008 or 2009 and exceed the 7.5% floor. For example, braces are discretionary, and medical procedures such as radial keratotomy and laser eye surgery may be discretionary and qualify for the medical expense deduction. **Tax Tip.** You can include in your medical expense the following: medical insurance premiums, transportation essential for medical care, lodging (but not meals) while away from home primarily for medical care, and changes to your house to accommodate a physical handicap. Tuition payments to a special school for a child with severe mental or physical disabilities (which would include medically diagnosed attention deficit hyperactive disorder) may also qualify as a medical expense. However, the IRS requires that a doctor recommend that a child attend the school, and the school generally must determine the portion of the tuition payment that relates directly to the medical needs of the child. Also, the costs of programs and prescription drugs to help people stop smoking qualify as a medical expense.

Take Advantage Of Health Savings Accounts (HSAs). Health Savings Accounts (HSAs) are one of the fastest-growing ways to save for health care. Qualifying contributions to health savings accounts (HSAs) are fully deductible whether or not you itemize deductions, and distributions for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). For 2008, if you have "family" coverage, your HDHP must have a minimum annual deductible of $2,200 ($1,100 for

self only coverage). For 2008, your maximum contribution to an HSA is $2,900 ($3,800 if 55 or older) for self-only coverage, and $5,800 ($6,700 if 55 or older) for family coverage, even if your qualifying HDHP deductible is less. **Planning Alert!** As long as you are covered by a qualifying high deductible health plan by **December 1, 2008**, you will be able to contribute up to the maximum 2008 contribution limitation (e.g., $5,800 for family coverage in 2008), subject to potential recapture rules.

Maximizing Employee Business Expenses. If you are incurring unreimbursed employee business expenses, you must reduce those expenses by 2% of your adjusted gross income. Bunching these expenses into 2008 or 2009 so the 2% threshold is exceeded may reduce your taxes. You can bunch 2009 expenses into 2008 by prepaying the 2009 amounts in 2008. **Planning Alert!** Unreimbursed employee-business expenses are not deductible at all for purposes of computing your alternative minimum tax. **Tax Tip.** If you are a statutory employee (e.g., full-time life insurance salesperson, certain commissioned drivers, certain home workers) you are not subject to the 2% limitation for employee business expenses. The statutory employee box on your Form W-2 should be checked if you are classified as a statutory employee.

Taking Advantage Of Employer's Accountable Plan. As an employee, you can avoid the 2% rule and the AMT exposure for employee business expenses, if you document your business expenses and get reimbursed by your employer under an accountable plan. We can help you establish a proper reimbursement arrangement with your employer. **Planning Alert!** Employees should always formally seek reimbursement from their employers for legitimate employee business expenses, or obtain a representation from their employer that it will not reimburse such expenses. Otherwise, the employee business deduction may be disallowed altogether.

Mileage Reimbursement Rates. This summer, IRS had some good news for businesses and individuals struggling with record-high gasoline prices. The IRS raised the business standard mileage reimbursement rate from **50.5 cents-per-mile to 58.5 cents-per-mile**. IRS also raised the standard mileage rate for medical and moving expenses from **19 cents-per-mile to 27 cents-per-mile**. However, the charitable standard mileage rate generally remains at **14 cents-per-mile**. Taxpayers may use the higher rate for business use of an automobile (and the higher medical/moving rate) for the **period July 1, 2008 through December 31, 2008.** Business travel before July 1 must be computed using the old rate of 50.5 cents-per-mile.

The Home Office Deduction. Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) may be easier than you think. If you're self-employed, you only have to establish that you use your home office "regularly and exclusively" to perform management or administrative duties for your business and that there is no other fixed location where you perform substantial management or administrative duties relating to that trade or business. If you are an employee, in addition to meeting the above requirements, you must also establish that your home office is "for the convenience of your employer" (this generally means you're not provided an office at work). **Tax Tip.** The IRS says that if you have a qualifying home office, you can deduct any travel from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement should be excluded from your income if reimbursed under an accountable reimbursement arrangement. If you are an employee and your home office expenses are not reimbursed, the home office expense deduction will be reduced by 2% of your adjusted gross income.

Charitable Contributions. You may save taxes by following the year-end planning techniques for charitable

contributions described below:

Be Sure to Pay Your Charitable Contribution in 2008. A charitable contribution deduction is allowed for 2008 if the check is mailed **on or before December 31, 2008**, or the contribution is made by a credit card charge in 2008. However, if you give a note or a pledge to a charity, no deduction is allowed until you pay off the note or pledge.

Tax-Free IRA Payments To Charities. If you have reached age 70.5, you may have your IRA trustee contribute up to $100,000 each year from your IRA directly to a qualified charity and exclude the distribution from your income (you **do not** get a charitable contribution deduction). This distribution to a charity also counts toward any "minimum required distribution" that you would otherwise be required to take during the year of the contribution. To qualify: **1)** you must have reached age 70.5 *before* the date of the transfer, and **2)** the IRA check must be made out *directly to the charity* (not to the beneficiary), although the beneficiary may *deliver* the check to the charity. **Tax Tip.** This provision is particularly beneficial if you do not plan to itemize your deductions (i.e., you plan to use the standard deduction), or you expect your itemized deductions to be reduced because your income exceeds certain thresholds. **Planning Alert!** Although this is generally an expiring provision, the *2008 Stabilization Act* extended it **through 2009.** If you have reached age 70.5, you should compare various options before disbursing IRA funds to a charity. Please call our firm and we will help you decide what's best for you.

Contributions Of Appreciated Property. If you are considering a significant 2008 contribution to a public charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute appreciated long-term capital gain property, rather than selling the property and contributing the cash proceeds to charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation.

Substantiation Requirements. If you contribute $250 or more to a charity, you are allowed a deduction only if you receive a *qualifying* **written receipt** from the charity by the time your return is filed. **Planning Alert!** Recent legislative changes to charitable contributions have not altered this requirement. You must receive this receipt **before** we file your 2008 return, and you should retain the receipt in your tax files in case you are later audited. IRS says a canceled check is **not** sufficient where a receipt is required! Also, no deduction will be allowed for charitable contributions of clothing or household items, unless the items are in good used condition or better. **Tax Tip.** You should consider contributing your clothing and household items to charitable thrift shops that have a policy of accepting only items that are in good condition.

Contributions Made In Cash or by Check. In order to deduct a charitable contribution made in cash, by check, or by other monetary means, the contribution must be supported by **1)** a bank record (e.g., a cancelled check), or **2)** a receipt, letter or other *written* communication **from the charity** showing the name of the donee organization, the date of the contribution, and the amount of the contribution. **Tax Tip.** Without these records, you are allowed no deduction at all, regardless of amount. Since a cancelled check satisfies these new requirements, you should consider replacing your cash contributions with a check. If you contribute by payroll deduction, IRS says that you will satisfy this new requirement if you have a pay stub or W-2 setting forth the contribution amount and a pledge card prepared by the charity. **Planning Alert!** If the contribution is for $250 or more, you will also need a written receipt as required under current law, including a statement indicating whether or not goods or services were received in return for the contribution.

Donations of Motor Vehicles, Boats, and Aircraft. Don't forget, there are stringent reporting and documentation requirements for the donor and the charity that must be satisfied in order to claim a charitable deduction in excess of $500 for a qualified vehicle. A qualified vehicle generally includes motor vehicles designed for highway use, boats, or airplanes. Generally, if you deduct more than $500 for a qualified vehicle, your deduction is limited to the gross sales proceeds received by the charity on the sale of that vehicle. In addition to this deduction limitation, a deduction exceeding $500 is not allowed at all unless you receive a Form 1098-C from the charity. **Tax Tip.** If your deduction is $500 or less, your deduction is not limited to the sales price of the vehicle, and you are not required to file a Form 1098-C with your tax return. However, if your deduction is at least $250, you must still obtain a qualifying written acknowledgment from the charity.

Maximizing Home Mortgage Interest Deduction. If you are looking to maximize your 2008 deductions, you can increase your home mortgage interest deduction by paying your January, 2009 payment on or before December 31, 2008. Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December. Here are some planning strategies you should consider:
Look For Deductible Points. Points paid in connection with the purchase or improvement of your principal residence are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include loan-processing fees, loan premium charges, or loan origination fees so long as they don't represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys' fees, credit checks, property taxes, or mortgage insurance premiums). **Tax Tip.** If 2008 marks at least the second time that you refinanced your home, and you are not refinancing with the same lender, you may deduct in 2008 the unamortized points from the previous refinancing.

Remember To Deduct Seller-Paid Points. If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.

Pay Off Personal Loans First. If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

Tax-Wise Payment Of State And Local Taxes. If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2008) and property taxes for 2008 prior to January 1, 2009 if your tax rate for 2008 is higher than or the same as your projected 2009 tax rate. This will allow a deduction for 2008 (a year early) and possibly against income taxed at a higher rate. **Planning Alert!** You should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, overpayment of your 2008 state and local income taxes is generally not advisable particularly if a refund in 2009 from a 2008 overpayment will be taxed at a higher rate than the 2008 deduction rate (e.g., because of the phase-out rules for itemized deductions). Please consult us before you overpay state or local income taxes!
Sales Tax Deduction. You may elect to deduct either state and local *income* taxes or state and local *sales* taxes, as itemized deductions. **Tax Tip.** This election may be particularly beneficial if: **1)** you are a resident of a state with little or no state income taxes, **2)** you reside in a state where the state income tax rate is generally lower than the sales tax rate, **3)** you are a senior citizen who has modest taxable income and you are living largely on lifetime savings, or **4)** your state income tax liability has been significantly reduced because of state credits, etc. Taking the sales tax deduction rather than the state income tax deduction may also avoid

including a state income tax refund in federal taxable income in a subsequent year. **Planning Alert!** If you plan to deduct sales taxes for 2008, consider purchasing your big ticket items such as a motor vehicle, boat, mobile home, or home building materials **by December 31, 2008.**

Planning With Education Costs

The following are the education tax breaks that you should consider as you develop your 2008 tax year-end planning strategies:

Don't Forget The Qualified Tuition Deduction. If you pay for *qualified* higher education tuition and fees for yourself, your spouse, or your dependents, you may qualify for an education expense deduction. This maximum $4,000 deduction is available whether or not you itemize. For **2008 and 2009**, you are allowed this maximum $4,000 deduction only if your adjusted gross income ("AGI") does not exceed $130,000 on a joint return ($65,000 if single). If your AGI is between $130,000 and $160,000 ($65,000 and $80,000 if you're single) your maximum deduction drops to $2,000. **Planning Alert!** If you expect to take this deduction and your income is close to the $130,000 or $160,000 limits ($65,000 or $80,000 if you're single), we should discuss your situation and see if we can take steps to keep your income below those thresholds for 2007. If you exceed the $160,000 or $80,000 limitation by even $1, the entire deduction is lost.

Student Loan Interest. You may deduct (whether or not you itemized deductions) up to $2,500 of interest on qualified student loans. Your deduction phases out as your adjusted gross income increases from **$115,000 to $145,000 on a joint return (from $55,000 to $70,000 on a single return).** The IRS says that if a family member pays your interest, the payment will be treated as a gift to you, and you will then be treated as paying the interest yourself. **Tax Tip.** If you paid any student loan interest in 2008, be sure to provide us with Form 1098-E. This will help us determine your interest deduction for 2008.

HOPE Education Tax Credit. If you pay post-high school education expenses for yourself, your spouse, or a dependent, you may be entitled to the HOPE education tax credit of up to $1,800 (up from $1,650 in 2007) per student. This credit is available only for two years of post-secondary education with respect to any one student. For a full-time student who enters college in the autumn, that means that the credit is available for two of the first three calendar years the student attends college. The credit phases out ratably as your modified adjusted gross income increases from **$96,000 to $116,000** on a joint return (**$48,000 to $58,000** on a single return). The HOPE credit equals 100% of the first $1,200 (and 50% of the second $1,200) of tuition and fees required by the educational institution. **Tax Tip.** To get the full $1,800 credit for 2008, you must pay tuition of at least $2,400 for the student **by December 31, 2008.** For example, if tuition is $1,200 each semester, you must pay two semesters of tuition in 2008 to get the full credit of $1,800. If your child began college in August or September of 2008, you should pay the $1,200 tuition for the spring semester of 2009 **no later than December 31, 2008** (payments after that date will **not** qualify for credit during 2008). **Tax Tip.** Unless more than one member of your family qualifies for either the HOPE credit or the Lifetime Learning credit for 2008, the Lifetime Learning credit (described below) will produce a larger tax benefit than the HOPE credit if tuition and fees paid for 2008 exceed $9,000.

The Lifetime Learning Credit. You may qualify for a *Lifetime Learning tax credit* of up to $2,000. This credit equals 20% of the first $10,000 of qualified higher education tuition and fees. The phase-out rules for the Lifetime Learning credit are the same as those for the HOPE credit, discussed above. Unlike the HOPE credit,

the Lifetime Learning credit is for an unlimited number of years and can be used for graduate or professional degrees (as well as undergraduate education). However, the Lifetime Learning credit **limitation of $2,000 is per tax return, not per student.** **Tax Tip.** In some situations, it may be better to claim the Lifetime Learning credit for qualified expenses that would otherwise qualify for the HOPE credit. For example, if a freshman's tuition is $10,000 in 2008, the Lifetime Learning credit would give you a $2,000 credit compared to the HOPE credit of $1,800. Keep in mind, however, that your total Lifetime Learning credit on your 2008 return cannot exceed $2,000. By contrast, you may take a HOPE credit of up to $1,800 for the tuition and fees for each family member who qualifies. **Planning Alert!** If your income **is more than $116,000 ($58,000 on a single return),** you do not qualify for the HOPE credit or the Lifetime Learning credit. However, the IRS says the student (e.g., your child) may claim the credits on his or her return, provided you elect not to claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent). Of course, since the HOPE and Lifetime Learning credits are non-refundable credits, your child must have sufficient income tax liability to utilize the credits on his or her return. **Caution!** Be sure to check with your health insurance carrier before releasing your child's tax dependency exemption to ensure that the release will not impair your child's health insurance coverage under your health plan.

Planning With Retirement Plans

Consider Contributing The Maximum Toward Your Retirement. As your income rises and your marginal tax rate increases, deductible retirement plan contributions generally become more valuable to you. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute, consider the following:

IRA Contributions. If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $10,000 ($12,000 if you're both at least age 50 by the end of the year) for contributions to you and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $5,000 ($6,000 if you're at least age 50) may be contributed to either you or your spouse's separate IRA for 2008. If you are an active participant in your employer's retirement plan during 2008, your IRA deduction is phased out ratably as your adjusted gross income increases from **$85,000 to $105,000** on a joint return (**$53,000 to $63,000** on a single return). However, if your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your ability to contribute the full amount to an IRA phases out only as your adjusted gross income on your joint return goes from **$159,000 to $169,000.** **Planning Alert!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2008, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$159,000 to $169,000** on a joint return or from **$101,000 to $116,000** if you are single.

Using IRA Funds for Education Expenses. If you have an IRA, you can withdraw funds for qualified higher education expenses without having to pay the normal 10% early distribution penalty. The distribution is, however, still taxable. **Tax Tip.** The distribution for higher education expenses, although taxable, may generate a HOPE credit or a Lifetime Learning credit. Also, these exceptions from the early distribution penalty only apply to distributions from IRAs.

Therefore, if you receive a distribution from your employer's retirement plan and you are not 59.5 or disabled, you will generally pay the 10% penalty tax even if you use the funds for qualifying education expenses. Consequently, a distribution from your employer's retirement plan **should be first rolled to an IRA** within the 60-day rollover period, and then distributed from the IRA for qualifying education expenses to avoid the 10% penalty. **Planning Alert!** You must withdraw the funds *in the same tax year* that you pay the qualified education expenses to avoid the 10% early distribution penalty. Therefore, if you have paid qualifying education expenses in 2008 and want a penalty-free reimbursement from your IRA, you must distribute the reimbursement **no later than December 31, 2008.**

Workers at Least Age 70.5. If you are age 70.5 or older, you **cannot** make a contribution to a traditional IRA. **Tax Tip.** If you are working, age 70.5 or older, have a spouse under age 70.5, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70.5.

Consider Contributing To Your Company's 401(k) Plan. If you are covered by your company's 401(k) plan, you should consider putting as much of your compensation into the plan as allowable. The maximum amount (employee portion) for 2008 is $15,500 ($20,500 if you're at least age 50 by the end of 2008). This is particularly appealing if your employer offers to match your contributions.

Converting From *Traditional* To *Roth* IRA. Currently, whether you file joint or single, you are not allowed to convert (rollover) your traditional IRA into a Roth IRA unless your modified adjusted gross income is $100,000 or less. In addition, if you are married, you must file a joint return with your spouse. **Tax Tip.** If you have little or no taxable income for 2008, you may be able to save taxes in the long-run by converting all or a portion of your regular IRA to a Roth. This is particularly true if the amount included in your income from the conversion does not increase your Federal or state tax liability. This strategy, in essence, will convert taxable retirement income into tax-free retirement income. If you want the conversion to be effective for 2008, you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2008** (you do not have until the due date of your 2008 tax return). **Planning Alert!** Under current rules, **effective for tax years beginning after 2009,** you will be able to convert your regular IRA to a Roth IRA, without regard to your income or your filing status. If you convert in 2010, unless you elect out, you will report the income triggered by the conversion pro rata in 2011 and 2012.

Planning With Credits

Don't Miss The Energy Credits. In 2005, Congress gave us several new credits for buying certain *hybrid vehicles*, or placing *qualified energy-efficient equipment* in our homes. If you are planning to purchase property that may qualify for any of these new benefits, and you want the tax credit in 2008, make sure that you complete the installation of qualifying property, or the

purchase of a qualifying hybrid vehicle, **by December 31, 2008** (for more information on energy tax credits go to www.energystar.gov and type in energy credits). **Planning Alert!** Under the technical language of the *2008 Stabilization Act*, the $500 credit for certain Energy-Efficient Home Improvements is available for 2007 and 2009, **but not for 2008.** The following are *selected* energy efficient tax credits that may be available to you:

Hybrid Vehicle Credit. Taxpayers who buy qualifying vehicles, may receive a hybrid vehicle credit. This hybrid credit is reduced once manufacturers produce over 60,000 energy-efficient vehicles. For example, purchases of hybrid vehicles manufactured by Toyota or Lexus after September 30, 2007 do not qualify for the credit. In addition, Honda hybrid purchases **after 2008** will not qualify for the credit. **Tax Tip.** The tax credit for qualifying hybrid vehicles manufactured by American companies (i.e., Ford, GM) qualify for the full credit, **at least through the end of 2008.** You can get an updated list of the credit status of all hybrid vehicles by visiting the IRS website at www.IRS.gov and typing in "hybrid cars and alternative fuel vehicles." If you are considering the purchase of a hybrid automobile, please call our office. We will help you determine whether the alternative minimum tax (AMT) will reduce or eliminate the tax benefit from the credit since the credit may not offset AMT.

30% Credit For Residential Energy-Generating Equipment. If you place *qualifying energy-generating equipment* in service with respect to your U.S. residence in 2008, you may qualify for a credit equal to 30% of the equipment's cost. The two most common classifications of qualifying energy-generating equipment, each of which qualifies for a separate credit, are: **1)** solar water heaters used in your principal or *secondary* residence that meets certain certification requirements (this credit may not exceed $2,000 for a taxable year), and **2)** qualified solar electric property which includes modular solar panels, commonly known as photovoltaics, PV panels, or PVs, that provide either a supplemental or exclusive source of electricity to your principal or secondary residence (although this credit is limited to $2,000 for 2008, **there is no dollar limit after 2008**). Thus, for 2008, you will get the maximum $2,000 credit if you have qualifying expenditures of at least $6,667 (i.e., $6,667 x 30% ‘ $2,000). **Tax Tip.** These two credits are allowed *each* tax year (there is no lifetime limit) and may offset AMT. You may be able to maximize these credits if you make separate qualifying improvements in separate tax years. Also, if you are planning to spend more than $6,667 on qualified solar electric property, you **should consider waiting until 2009** to complete the installation so that you can avoid the current $2,000 cap. **Planning Alert!** Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify for this credit.

Adoption Tax Credit. If you are considering adopting a child, the adoption tax credit may substantially reduce your tax bill. For 2008, you may be entitled to an adoption tax credit for qualifying adoption expenses of up to $11,650 per child. However, the adoption credit is phased-out as your modified adjusted gross income increases from $174,730 to $214,730. **Tax Tip.** If you finalize the adoption of a special needs child **by December 31, 2008**, you may receive the full adoption tax credit of $11,650 even if this is more than your adoption expenses. This credit for the excess of $11,650 over your actual expenses is allowed only in the year the

adoption is finalized.

Other Items To Consider

Don’t Miss Use-It-Or-Lose-It Deadline. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). Flex plans have a key deadline. For most *calendar-year* plans, you must clean out your 2008 account by March 15, 2009, or forfeit any funds that aren't used. **Planning Alert!** This deadline applies only to flex plans **that were amended** to give participants 22 months after year-end to use up amounts for 2008. If your calendar-year flex plan has not been amended, you must use up your account by **December 31, 2008.**

Penalty For Under-Withholding Or Under-Estimating. One way to avoid a penalty for failing to pay or withhold sufficient income taxes for a tax year is to pay 100% of your prior year’s tax liability in quarterly estimated payments or through income tax withholding. **Planning Alert!** If your 2007 AGI was over $150,000, you must pay in 110% of your 2007 tax liability to qualify for this safe harbor in 2008. **Tax Tip.** If you have not paid sufficient estimates to avoid an underpayment penalty for 2008, you may have additional amounts withheld from your wages, year-end bonuses, or IRA distributions **on or before December 31, 2008.** Any withholding for 2008 is deemed paid equally on each quarterly installment date for estimated tax purposes, even if the withholding occurs in December.

FINAL COMMENTS

Please call us if you are interested in a tax topic that we did not discuss. Tax law constantly changes due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes and we will be glad to discuss any current tax developments and planning ideas with you. Please note that the information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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