



# Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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## Your Rebate Checks Are In... But What Does This Mean for 2009?

By the time you read this article, the IRS has already started sending out the stimulus rebates. A new schedule was released, accelerating the distribution of the payments. Payments were direct deposited into qualifying individuals' bank accounts starting April 28 instead of May 2, and paper checks were mailed starting May 9 instead of May 16. The schedule that was released in March remains the same, with payments either direct deposited or put in the mail by the dates listed on the schedule.

These rebates are actually advance payments for a new refundable tax credit called the "Recovery Rebate Credit" that is claimed on your 2008 tax return and must be accounted for when you file the 2008 tax return. So the government can get the money into people's hands quickly and not wait for the 2008 returns to be filed in 2009, the IRS will calculate and mail out advance payments of this 2008 credit based upon the information included on a taxpayer's 2007 tax return. The IRS will make a direct deposit of the advance payment into a taxpayer's account if direct deposit was requested for the 2007 return refund. When the taxpayer files his or her 2008 return, the Recovery Rebate Credit will be reduced by the amount of the advance payment. Should the advance payment exceed the amount of the credit, the taxpayer will not be required to make up the difference!

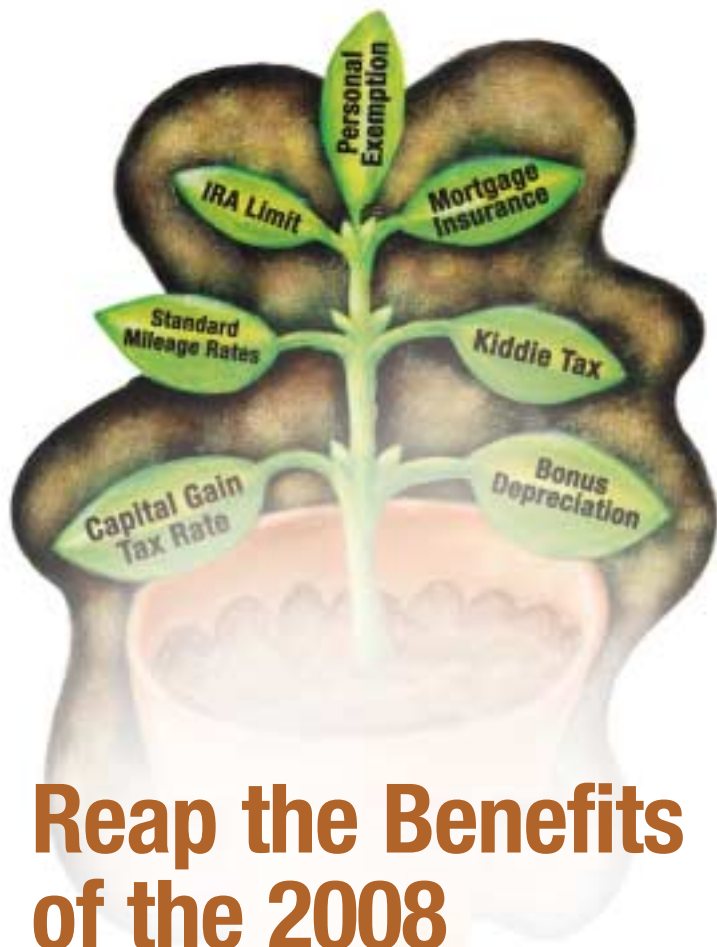
Since these advance payments (cash rebates) are computed based on the data from the 2007 return, a 2007 return must be filed to obtain a cash rebate. Thus, some taxpayers (such as those receiving SS income and who are not otherwise required to file a

return and otherwise qualify for the rebate) must file one to qualify for the advance payment. However, if a taxpayer does not file a 2007 return, he or she still would qualify for the Recovery Rebate Credit when a 2008 return is filed. This also applies to taxpayers who file late. They do not lose the Recovery Rebate Credit; they just do not receive it in advance and will have to wait for the benefit when their 2008 return is filed. The IRS is prohibited from issuing advance payments after December 31, 2008.

**How much will your rebate be?** The rebates are broken into two categories, the basic credit rebate and the qualifying child rebate credit. For the basic credit rebate, a single person with no qualifying children gets a maximum rebate of \$600 or a minimum rebate of \$300. A married couple filing jointly with no qualifying children gets a maximum rebate of \$1,200 or a minimum rebate of \$600. To receive the maximum, your 2007 tax (figured in a special way) must be \$600 or more for a single person and \$1,200 or more for a married couple filing jointly. To get the minimum, you must have at least \$3,000 of qualifying income (explained above) or owe tax (figured in a special way) of at least \$1. Your rebate amount will fall in between the minimum and maximum if your tax is more than \$300 but less than the maximum rebate for your filing status. In that case, your rebate will be equal to your tax. Let's say that you are single and that your tax is \$500. In this scenario, your rebate will be \$500.

*(...Cont'd on Page 3)*





# Reap the Benefits of the 2008 Tax Law Changes

It is rather difficult to stay on top of your taxes, considering all of the changes going into effect this year – and with Congress working on more provisions.

To simplify it all, here is a rundown of most changes that will affect individuals and small businesses in 2008.

**Forgiveness of Mortgage Debt** – Although this technically is not new for 2008, it passed late in 2007 and was made retroactive to the first of 2007 and effective through 2009. Normally, debt forgiveness results in taxable income. However, struggling homeowners whose mortgage debt is partly or entirely forgiven may be able to claim special tax relief that allows them to exclude debt forgiven on their principal residence if the balance of their loan was less than \$2 million (\$1 million for married taxpayers filing separately).

**Itemized Deduction Phase-Out Reduced** – Certain itemized deductions of higher-income taxpayers are reduced when their income (AGI) exceeds a specified inflation-adjusted amount. This reduction is being phased out. For 2008, a taxpayer will lose only one-third of the amount that he or she would otherwise lose under the regular reduction computation.

**Personal Exemption Phase-Out Reduced** – The personal exemptions of higher-income taxpayers are reduced when their income (AGI) exceeds a certain inflation-adjusted amount. This reduction is being phased out. For 2008, a taxpayer will lose only one-third of the amount that he or she would otherwise lose under the regular reduction computation.

**Mortgage Insurance Deduction Extended** – Originally scheduled to expire in 2007, the mortgage insurance premiums deduction has been extended through 2010. This deduction applies only to mortgage insurance contracts issued after 2006.

**IRA Limit Increased** – For 2008, the IRA contribution limit has been increased by \$1,000 to \$5,000 (\$6,000 if age 50 or older) but still is limited to 100% of compensation. The inflation-adjusted deductibility phase-out income limitation is increased slightly to \$63,000 (\$105,000 for joint filers) for filers with employer plans.

**Standard Mileage Rates** – The mileage rate for getting medical care or for a job-related move has been reduced to 19¢ per mile. For charity use, the amount remains unchanged at 14¢ per mile, while the business use rate increased to 50.5¢ per mile.

**Tax Relief for Volunteer Responders** – Effective in 2008 through 2010 is an exclusion from income for certain state or local tax benefits (a rebate or reduction of state or local income or property tax) and qualified payments (up to \$360 a year) granted to members of qualified volunteer emergency response organizations.

**Bonus Depreciation** – For businesses, the 50% bonus depreciation (which applies to most tangible property, purchased computer software, and qualified leasehold improvement property) has been reinstated for 2008 only and allows a deduction for up to 50% of the cost of the property the first year with the balance depreciated in the normal manner.

**Increased Section 179 Deduction** – For 2008, the Section 179 expense deduction limit has been increased to \$250,000, and is phased out for larger companies by the amount by which the cost of Section 179 property placed in service during the tax year exceeds \$800,000.

**Kiddie Tax Broadened** – For 2008, the kiddie tax is expanded to apply to children age 18 and children over age 18 but under age 24 who are full-time students – if their earned income doesn't exceed one-half the amount of their support.

**Alternative Minimum Tax (AMT)** – Congress has long been patching the AMT from year to year. Although it has discussed meaningful AMT reform, there is nothing to date. There is a very good chance that Congress will “patch” the AMT yet again for 2008; however, there is no guarantee.

**Expiring Provisions** – Several popular deductions expired at the end of 2007. Thus, unless Congress decides to extend them later in the year, the following provisions will not apply to the 2008 returns:

- **Educator expenses:** The above-the-line deduction for educator expenses.
- **Tuition and fees deduction:** The above-the-line deduction for higher-education expenses.
- **Option to claim state and local sales tax as an itemized deduction instead of deducting it:** This option will have the greatest impact on taxpayers who reside in states with no income tax, since this was a bonus for them.
- **Tax-free distributions from IRAs for charitable purposes**
- **Election to treat combat pay as earned income:** Can reduce or eliminate the earned income credit (EIC) for military personnel.
- **Penalty-free withdrawals for individuals called to active duty:** This provision allowed penalty-free IRA, 401(k), and tax-sheltered annuity withdrawals for taxpayers called to active duty.
- **Credit for energy-saving home improvements:** A nonrefundable credit of up to \$500 for making qualifying energy-saving improvements to a home.
- **Research credit**

If you would like to discuss any of the topics in greater detail, please call our office for an appointment.

### *(Your Rebate Checks Are In...But What Does This Mean for 2009? Cont'd...)*

An eligible individual who is entitled to any amount of the basic credit is also allowed a credit equal to \$300 for each qualifying child of the individual in addition to the basic credit. "Qualifying child" has the same meaning for this purpose as it has for purposes of the child tax credit. Thus, for each child who qualifies for the child tax credit, a taxpayer qualifies for an additional \$300 rebate.

For example, a married couple filing jointly with one qualifying child could be eligible for a maximum rebate of \$1,500 (\$1,200 + \$300).

**Phase-out for higher-income taxpayers:** The amount of the rebate (both the basic and the child amount) is reduced by 5% of a taxpayer's adjusted gross income (AGI) above \$75,000 (\$150,000 for joint returns). For example, a married couple filing jointly with one child has an AGI of \$170,000 and a net tax liability of over \$1,200. Their rebate is \$500: [\$1,200 basic rebate plus \$300 qualifying child rebate – \$1,000 phase-out (i.e., 5% x (\$170,000 - \$150,000))].

**Do all qualified individuals get rebates?** No. Each individual must qualify for the rebates in one of two ways, and the rebates and the credit in 2008 is phased out for higher-income taxpayers. To qualify, a taxpayer must (1) owe tax, as computed in a special way, or (2) have at least \$3,000 of qualifying income. Qualifying income generally includes earned income, social security benefits, and veterans' disability payments (including payments to survivors of disabled veterans).

If you think that you might qualify for the rebate and have not yet filed a return, please call this office for assistance.

## Zero Capital Gains Rate in 2008 Requires Careful Planning

One of the greatest benefits of the tax code is the special tax rates that currently apply to gain recognized from the sale of capital assets held for more than a year (long-term). The special tax rates apply to virtually all capital assets, including land, improved real estate, your home, and business assets in excess of the accumulated depreciation previously deducted. Beginning this year, 2008, these special rates, which apply to net long-term capital gains (LTCG)<sup>(1)</sup> and qualified dividends, drop to zero percent to the extent that your regular tax rate is less than 25% and 15% for all other capital gains. These rates, which apply only to non-corporate taxpayers, also apply for the alternative minimum tax and are available through 2010 barring any future tax law change.

This zero tax rate provides an extraordinary opportunity for a taxpayer to cash in on certain gains and pay no tax. This could be tax paradise for those who carefully plan their transactions this year through 2010.

The conventional strategy in the past was to offset as much of your gains as possible with losses from selling other assets in your portfolio. If you have an overall loss, then it is limited to \$3,000 (\$1,500 for married taxpayers filing separately), and any excess carries over to the next year. Keep in mind that losses from the sale of business assets are generally separately allowed in full in the year of sale, and not mixed with the losses from the sale of other capital assets. So with this change in the law, a new strategy emerges: it may be more appropriate to take gains to the extent they would be taxed at zero percent.

What this zero tax means to you is that there is no tax on your long-term capital gains to the extent that your regular tax rate is less than 25%. Before you make plans to sell everything in 2008 through 2010, remember that the gain itself adds to your income, impacts income-based limitations, and may possibly push you into a higher regular tax bracket, so it is a balancing act to take advantage of this zero rate. Of course, you can also use losses to offset the gains but, contrary to past conventional strategy, you should have enough losses only to keep the gain within the zero tax rate. If your income is too high to take advantage of the zero tax rate, then continue to employ the conventional strategies discussed above for 2008 through 2010.

The zero tax rate applies to the amount of your taxable income below the 25% tax bracket. For 2008, this "breakpoint" is the "top" of the 15% bracket and is:

- \$32,550 for single taxpayers and married taxpayers filing separate returns;
- \$65,100 for married taxpayers filing joint returns and surviving spouses; and
- \$43,650 for heads of households.

Thus, the amount of your adjusted net capital gain taxed at 0% is:

- (1) The breakpoint amount for your filing status, minus
- (2) Your "other" taxable income (taxable income reduced by adjusted net capital gain).

The following issues may also come into play when planning your capital gains and losses strategies: (1) Gains from the sale of inherited capital assets are automatically long-term; (2) By election, long-term capital gains can be used to increase the amount of investment income when figuring the investment interest deduction, but then aren't eligible for the lower capital gain tax rates; (3) Losses from selling personal-use capital assets, such as your home or auto, are not deductible, and (4) You may have short and/or long-term capital losses from a prior year to account for. Also take into consideration how your state taxes capital gains; most do not have a 0% LTCG rate, and many do not have any special rates for capital gains.

Please give our office a call so that we can help you develop a strategy that will suit your unique situation.

*(1) Net capital gain is generally the excess of net long-term capital gains over net short-term capital losses, subject to certain netting rules. However, the zero tax rate doesn't apply to collectibles gain or gain taxed on sales of certain small business stock, both taxed at a maximum rate of 28%, or to unrecaptured Sec. 1250 (depreciation) gain, which is taxed at a maximum rate of 25%.*

# Tax calendar

June – September

## June 16, 2008:

- U.S. citizens living abroad on April 15, 2008 must file a 2007 income tax return (if not already filed) or file for an extension.
- The second installment of your 2008 individual estimated taxes is due. If your income or deductions have significantly changed, you should call this office to determine if any adjustment in estimates is appropriate.

## July 2008:

- Time to review your 2008 year-to-date income and expenses to ensure that your estimated tax payments and withholding are adequate to avoid

underpayment penalties. There have been a significant number of tax changes for 2008 that can impact your estimated taxes for 2008.

## July 31, 2008:

- This is the due date for self-employed individuals and employers to file 5500 series returns for 2007 calendar year benefit plans (including Keogh/HR-10 plans).

## September 15, 2008:

- The third installment of your 2008 individual estimated taxes is due.

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

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## Since You Asked...

**You Asked:** I am downsizing from a large home to a much smaller one. As a result, I will need to divest myself of a significant amount of household and personal items and plan on giving them to charity. The fair market value of the items may well be over \$6,000. What are the issues related to such a contribution?

**Answer:** Any contribution of non-cash items in excess of \$250 for the year will need to be supported by written verification from the charity. A detailed list of the items contributed should be provided, including a description, the original cost, the date acquired, and the current fair market value of each item. If the donation exceeds \$500, the list must be attached to your tax return. More importantly, a contribution of non-cash items in excess of \$5,000 must have a qualified appraisal documented on IRS Form 8283. There are some exceptions, but generally, the \$5,000 amount applies to the sum of the contributions for the year,

not the individual donations made during the year. You also should be aware that contributions of household items and clothing generally must be in good or better condition.

**You Asked:** I am in the process of changing jobs. What should I do with the 401(k) plan I have with my existing employer?

**Answer:** You can roll the funds over or make a trustee-to-trustee transfer into either an IRA account or your new employer's 401(k) plan, if one is offered and rollovers are accepted from other plans. It is generally better, for tax reporting issues, to transfer the funds between plans rather than take a distribution. If you take a distribution, keep in mind that the rollover must be completed within 60 days or it becomes taxable. If you are considering your new employer's plan, investigate your investment options and plan fees before making the transfer.

