



tax & financial

U P D A T E



Volume 15, Number 1 Spring/Summer 2008

contents:

- Tax Calendar
- Reap the Benefits of the 2008 Tax Law Changes
- Your Rebate Checks Are In...But What Does This Mean for 2009?
- Be Strategic with Your Estate Plan
- Since You Asked...

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).

Capital Gain Tax Rate Reduced – Beginning this year and continuing at least through 2010, a zero-tax rate applies to most long-term capital gain and dividend income that otherwise would be taxed at the regular 15% rate and/or the regular 10% rate.

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.

(Cont'd on next page)

(Reap the Benefits of the 2008 Tax Law Changes Cont'd...)

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?

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.

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.

Be Strategic With Your Estate Plan

People tend to be complacent about preparing for their eventual demise, mostly because it is something that they do not want to think about. However, death is an inevitable part of life, and planning for it ahead of time would benefit both you and your loved ones. Before setting up your estate plan, the following items should be taken into consideration.


- **Structure your estate plan to take advantage of dual estate tax exemptions.** When a person passes away, the first \$2 million (in 2008) of his or her taxable estate is exempt from federal estate tax (inheritance tax). Any amount over that is subject to tax. For married couples, there is an unlimited marital exemption so that the surviving spouse can inherit the deceased spouse's estate without paying any inheritance tax. Consequently, the entire joint assets are placed in the surviving spouse's estate, and when the surviving spouse passes, his or her estate receives the benefit of only a single estate tax exemption.

However, a married couple can escape estate tax on assets of up to two times the exemption amount (\$4 million in 2008 or \$7 million in 2009) if the couple's wills are drafted to take full advantage of each spouse's own exemption amount. The wills should provide that, when the first spouse dies, the amount protected from estate tax per the available exemption amount will pass to a trust from which the surviving spouse can benefit during his or her remaining lifetime, but which will not be included in the surviving spouse's estate at death.

If you own a home, carry some life insurance, and are entitled to retirement plan benefits from work, your gross estate already may exceed the threshold at which estate tax liability begins. Since the top estate tax rate is 45%, planning to make the best use of your exemption is essential. For individuals with very large estates, there are additional estate planning techniques that can help maximize the amount of the estate that will pass to the heirs.

- **Make adequate beneficiary designations.** The beneficiary designations for your insurance policies, annuities, employer retirement plans, and IRA accounts should be current and coordinated with your overall estate plan. You also may have designations that are no longer appropriate due to death, marriage, divorce, or other situations that have changed over the years. There are also tax rules that specify distribution options for IRA and pension plans that should be considered in your estate plan. Failure to plan properly could have disastrous income and estate tax consequences.
- **Consider the options available to finance long-term care needs.** The life expectancy of Americans continues to increase, and the older that we become, the less likely we are able to live independently. An AARP study found that 82% of individuals age 85 and older have a chronic condition or disability for which they might need assistance. The cost of nursing and hospice care can quickly devour your personal financial resources and ultimately burden your spouse or other loved ones. Unless you are wealthy enough to be self-insured, planning options to consider include long-term care insurance or life insurance to replace the wealth lost by the family to long-term care costs. Although Medicaid is another source of funds for long-term care financing, it may not provide a standard of living that is desirable.

If you have a specific question regarding any of the information provided here, please call our office for an appointment.



Since You Asked...

You Asked: My husband passed away in 2006, and I will be selling my home this year. We purchased our home many years ago for \$60,000, and I will sell it for about \$900,000. Do I qualify for the \$250,000 or \$500,000 home gain exclusion?

ANSWER: Under a recent law change effective for years 2007 and later, a surviving spouse who otherwise qualifies for the home gain exclusion can exclude up to \$500,000 if the sale occurs no later than two years after the spouse's death. So, you may qualify for the larger exclusion if you sell it within that two-year period. However, don't overlook the fact that you have a stepped-up basis as a result of your spouse's death. Generally, depending upon how the title was held and which state you live in, your tax basis in the property will be either the fair market value (FMV) of the home at the date of your spouse's death or half of the FMV of the property plus half of the joint basis. Assuming the latter and that the home's

FMV was \$800,000 on the date of your husband's death, you would measure your gain from \$430,000 (half of \$800,000 + half of \$60,000).

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.



taxcalendar JUNE-SEPTEMBER 2008

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.