2008 Tax Planning Letter

November 18, 2008

Dear Client:

New legislation, expiring provisions and older provisions coming into effect make 2008 and 2009 interesting years for taxpayers. We have tax-free capital gains, a $7,500 credit for people who may be buying their first home for the 12th time, a property tax deduction for people who don't itemize, and other unique problems and opportunities.

Business Changes:

Federal 50% Bonus Depreciation in 2008: The Economic Stimulus Act of 2008 provides a major benefit to businesses in the form of reinstating bonus depreciation for tangible personal property. Taxpayers are permitted to claim 50% first-year bonus depreciation of the adjusted basis of the qualifying property placed in service in 2008. Property must be new!! ***Be sure to buy assets and place them in service before December 31, 2008, to take advantage of the 50% Bonus Depreciation! This is true for calendar and fiscal year taxpayers.***

Qualifying Property:

- Property eligible for modified accelerated cost recovery system (MACRS) depreciation of 20 years or less;
- Water utility property;
- Off-the-shelf computer software eligible for MACRS depreciation over three years; and
- Qualified leasehold improvement property depreciated under MACRS (generally, improvements made to the interior portion of a building that is nonresidential real property, made under or pursuant to a lease by the lessee, sublessee, or lessor. The improvement must also be placed in service more than three years after the building was first placed in service).

Section 179 Depreciation: The Stimulus Act provides that, for tax years beginning in 2008 (only), the maximum regular Section 179 expense deduction is $250,000. The threshold amount is increased to $800,000; that is, the $250,000 limitation is reduced by the amount by which the cost of Section 179 property placed in service during the tax year beginning in 2008 exceeds $800,000.

California Depreciation: California limits the expense to $25,000. The California threshold is $200,000.

Standard Mileage Rates:

	2007	January 1 to June 30, 2008	July 1 to December 31, 2008
Business Mileage	48.5 Cents	50.5 Cents	58.5 Cents
Charitable Mileage	14 Cents	14 Cents	14 Cents
Medical & Moving	20 Cents	19 Cents	27 Cents

Mileage			

More Rebate Money? Your rebate can increase if your income or filing status changes in 2008. The rebate cannot go down, but it can go up. Let's look at last minute things we can do to possibly increase the rebate based on your 2008 income.

First time home buyer credit: Federal law now provides up to a $7,500 credit on your return if you are a "first time home buyer" (you haven't owned a home in three years). **Warning**: This "credit" is really a loan and you will be charged $500 each year until you repay the $7,500 or you sell the house and repay the balance then. If you are considering using the credit, let's talk about the ramifications.

Dividends and capital gains may be tax free! For tax years 2008-2010, dividends and capital gains may be taxed at either 0% or 15%. We need to look at two issues here: First, planning income to take advantage of 0% capital gains; second, with a new administration in the White House, the 15% rate could go away as early as 2009. If so, maybe we want to accelerate those gains.

The AMT monster: More and more taxpayers are getting caught by the alternative minimum tax (AMT). Proper planning can avoid or minimize its effects especially in light of new laws providing for a refundable credit and other new benefits. Let's plan how to deal with the AMT monster.

New for 2008! Standard Deduction for Property Taxes: For tax years beginning in 2008, the Housing Act allows an addition to the standard deduction for property taxes paid equal to the lesser of the amount paid or $500 ($1,000 married filing joint). The Emergency Economic Stabilization Act extended this provision for one year so that taxpayers may take this deduction in both 2008 and 2009.

More real estate changes coming: Beginning January 1, 2009, any time your property is not used as your principal residence it will reduce the amount of your home sale exclusion. If you are planning to convert rental property to a principal residence to use the exclusion later, we need to talk about it.

Selling real estate? California requires withholding on a sale of real estate. The amount could be over $15,000 on property sold for just $500,000. There are exceptions from this withholding and ways to reduce it but you must file certain forms BEFORE escrow closes. Call us if you're selling any real estate.

Losing real estate? If you're losing — or under threat of losing — your home or other real estate in a foreclosure, let's get together. As hard as it may be to understand, you can end up with a big tax bill after losing a home. Fortunately, there are tax strategies to avoid that. The same applies if the lender drops the amount of your loan.

Net operating losses (NOL): California has just enacted a new law suspending NOLs in 2008 and 2009 but there is an exemption for "small businesses." Let's discuss this, and if you have an NOL, let's make sure you qualify as a small business.

California Changes to Estimates: If you are required to make estimated payments, the legislature accelerated estimated tax payments for individuals and corporations by requiring the first two payments to be 30% and the second two payments to be 20% of the "required annual payment."

30%	January 1 to March 31	Due April 15
30%	April 1 to May 31	Due June 15
20%	June 1 to August 31	Due September 15

20%	September 1 to December 31	Due December 31 or January 15

*See us Regarding AMT Issues

IRA distribution: If you are age 70½ or older, you must make minimum distributions from your IRA or pension plan. Taking too little out of the plan can subject you to strict penalties. Taking too much may cause a tax burst. As your bank or investment firm will not automatically do this for you, let's sit down and plan for the correct amount to withdraw. Remember, the withdrawal must happen prior to the end of the year.

Charitable contribution of IRA is back: For 2008 and 2009, an individual aged 70½ or older may make a direct contribution of IRA funds to a charity. You may contribute your required minimum distribution to a charity and reduce your income. If you don't itemize deductions, this is a perfect way to save tax and benefit your favorite charity.

Rollovers to HSAs: For tax years beginning on or after January 1, 2007, taxpayers are allowed direct trustee-to-trustee rollovers from an IRA to an HSA. The amount is limited to the otherwise HSA deductible amount for the year. Only one such rollover can be made during a lifetime with one exception: If the rollover is made at a time when the taxpayer has self-only coverage, a later rollover in the same year may be made at the time the taxpayer has family coverage.

Stock losses: If you have large capital gains, you may want to reduce them with losses. If you want to take losses but still like your stock, consider using the wash sale rules to sell the stock and repurchase it after 30 days. This can be tricky so we need to talk about the alternatives.

Roth conversions: Had a bad year? Consider converting traditional IRA funds to Roth IRA for this year. Also, in 2010, you will be able to convert to a Roth, no matter what your income level. There are things to be done now to prepare for the change.

Social Security double whammy: At certain income levels, every dollar of additional income causes a $1.50 increase in taxable income. So we should plan when to recognize or avoid income whenever possible.

Kiddie tax: Students are now subject to kiddie tax as long as they are under age 24. Let's look at some opportunities to postpone income for kiddies and increase their spendable college cash. To make things even more complicated, under California law, your dependents are treated as "kiddies" only until they're 14.

Pension plans: Be sure to establish a pension or profit sharing plan prior to the end of 2008. You have until you file your return to fund the plan, but except for IRAs and SEPs, the plan must be established prior to the end of the year.

Bunching deductions: We should always look at the time-honored strategy of bunching deductions to maximize their benefit. In doing so, we will look at itemizing versus standard deduction and the dreaded alternative minimum tax. It can be tricky, so let's put together a good strategy to beat the tax man.

LAST BUT NOT LEAST

THE HOUSING ACT OF 2008 REMOVES ONE OF THE BEST TAX LOOPHOLES WE'VE HAD FOR YEARS!!

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two out of the last five years ending on the sale or exchange.

Under the Act, for sales after December 31, 2008, the gain from sale or exchange of a principal residence will no longer be excluded from gross income for periods that the home was not used as the principal residence.

The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by a fraction the numerator of which is the aggregated periods of nonqualified use during the period the property was owned by the taxpayer and the denominator of which is the period the taxpayer owned the property.

Example: *You own a second home (vacation home) and have been planning to retire. You sell your main home and move into your second home for a couple of years before selling it as well, expecting to reap the benefits on both homes. If you move by January 1, 2009, the old strategy will continue to work, no matter how long you owned the second home before moving. On the other hand, anytime after 2008 that your second home is not your principal residence will count as a period of nonqualified use and cause at lease part of your gain to be subject to tax.*

These are just a few of the common tax-planning strategies we should talk about before the end of the year. There may also be other things that relate to your specific situation. Please call my office and come in as soon as possible so we can plan to reduce your taxes. Please visit us online at www.rdaviscpa.com

Sincerely,

Robert C. Davis CPA