

2008 MID-YEAR TAX PLANNING NEWSLETTER

Tax planning has become increasingly complicated. Congress in the past several years has passed legislation that phases in, phases out, or sunsets. They apply some laws retroactively or for the future! Or our personal favorite, the 12th hour legislation where your planning has to be centered on "if you only had a crystal ball," will they or won't they extend the friendly rules or take the more aggressive approach.

In this ever-changing environment, it is challenging to stay informed, understand the changes and finally apply those changes into a tax plan. But make no mistake; it is clear that a failure to plan may lead to missed opportunities or an unexpected tax bill.

The earlier you assess your individual and company's short and long-term goals and financial needs, the more effective the tax planning strategies can be. Reading this letter is your start to consider the tax planning moves that will assist you to achieve your goals. If you have any questions about anything in this letter or maybe what's not in this letter, please call! We will be committed to work with you to find the tax strategies that fit your particular needs.

INVESTMENT & RETIREMENT STRATEGIES

Kiddie Tax Rules. Those with existing significant investment portfolios have additional tax planning decisions to make. Under the kiddie tax law, any amount of a child's unearned income, such as interest, dividends and capital gains, in excess of \$1,800 is taxed at the parent's marginal tax rate. This rule applied to children under the age of 18 in 2007. But with the signing of the 2007 Small Business and Work Opportunity Tax Act, the age has been raised in 2008 for all children under 19 and dependent college students under age 24. Shifting investments to a child's account was once a popular college savings strategy, but this new law greatly lessens the advantage. A good alternative may be investing in a 529 college savings plan, where funds grow tax-free and subsequent withdrawals are tax-free for qualified secondary education expenses.

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Retirement Funds. Let's face it, people invest because they want to retire and in a manner close to their current lifestyle. Whether you own your own business or not, there are tax planning strategies you may not be utilizing to the fullest. But when it comes to retirement savings, the number one rule is to contribute the maximum amount allowed every year. The following apply for the 2008 tax year:

- ◆ ***Participants in a 401(k) plan can defer the lesser of \$15,500 or 100% of compensation (\$20,500 for ages 50 or older).***
- ◆ ***The IRA Contribution limit rises to \$5,000 (\$6,000 for ages 50 and older)***
- ◆ ***Simple IRA participants can defer the lesser of \$10,500 (\$13,500 for age 50 and older) or 100% of compensation.***
- ◆ ***Self-Employed individuals can contribute the lesser of 25% of the owner's adjusted income or \$46,000.***

Contributions to your 401(k) plan, Simple Plan, deductible IRA or other tax-deferred retirement plan provide current tax deductions and defer taxation on income within the account until distributions are made. These plans are obviously beneficial for reducing your current and future income taxes, as well as providing retirement funds. Except for the IRA, you generally can't wait until the end of the year to make these investment decisions.

Even though there are significant benefits to making tax-deductible IRA and 401(k) contributions, the long-term financial benefits of a Roth IRA or a Roth 401(k) can exceed the long-term financial benefits of the tax-deductible contributions. With a Roth account, the contributions to the plan are not tax deductible. However, as long as there are no premature

distributions, none of the income earned inside the Roth account will be subject to an income tax. In addition, the Roth account is not subject to the required minimum distribution rules that take effect when you reach age 70½, which may provide substantial estate tax benefits.

If you think the Roth IRA is a good idea for you, there is good news! Beginning in 2008, you can make a direct rollover from your qualified retirement plan (such as 401K or 403B plan) into a Roth IRA. Before you make the switch, you should know that this rollover will trigger income taxes. However, if your adjusted gross income exceeds \$100,000, you are not eligible to participate in this rule. Starting in 2010, anyone, regardless of adjusted gross income, can take advantage of this rule.

INDIVIDUAL INCOME TAX STRATEGIES

Stimulus Payments. There has been a lot of publicity about those 2008 stimulus checks being issued by the IRS starting in May. Some of you may have already received yours. These checks were Congress' attempt to spur spending and boost the American economy. In general, taxpayers will receive a \$600 rebate for 2008 for single taxpayers (\$1,200 for joint returns) up to the amount of their 2007 tax liability. However, low-income people, including some retirees will receive at least \$300 as long as they file a 2007 tax return. In addition, there is a \$300 credit for each qualifying child under age 17. Please keep in mind that you will not receive your rebate check until you have filed your 2007 tax return. The check amount begins to phase out at \$75,000 for single taxpayers (\$150,000 for married filing joint) and is totally phased out if you make over \$87,000 and \$174,000 respectively.

Planning Your Deductions. Depending on your facts and circumstances, valuable and even significant income tax savings can be gained. You may benefit from taking advantage of deduction "bunching." Some itemized deductions are subject to various floors and limits before you can claim them. By understanding this and planning so that your expenditures fall into one tax year instead of being spread over two years, you may create tax savings. These rules apply to several expenditures especially medical expenses, property taxes, and charitable contributions. Unfortunately, taxpayers who are consistently subject to alternative minimum tax may not benefit from this strategy.

Starting in 2007 (through 2010), mortgage insurance premiums are deductible in addition to mortgage interest. This tax relief provision for homeowners allows taxpayers to treat mortgage insurance as home mortgage interest - therefore making it deductible in most instances. The insurance must be on a contract issued after 2006 and paid by the taxpayer. This tax break is phased out for higher income levels.

Over the past few years, the IRS has created stricter rules for deducting charitable contributions. It is important that you understand these rules so that you do not lose out on your deductions. Cash contributions of less than \$250 must now be supported by a qualified receipt, cancelled check or credit card statement in order to be deductible. In addition, contributions of used clothing and household items must be in good condition or better to qualify for any deduction. The IRS has also taken a stern position on cars given to charity. Contribution deductions for vehicles are generally limited to the actual proceeds received by the charity upon sale.

It is also important to know that several 2007 deductions have not yet been extended to 2008, including the sales tax deduction on Schedule A, adjustments for educator expenses, and the college tuition and fees deduction. Based on the political climate in the fall, these provisions may or may not be extended.

Alternative Minimum Tax (AMT). Although you may not clearly understand what it is, by now most of you have heard about its dreaded traps. This tax, initially created to make certain the wealthy pay their fair share, has now expanded to middle income taxpayers in a very negative way. Late in 2007, Congress passed a Bill to reduce the number of middle income Americans from being subject to AMT. This patch was for a single year; and therefore, we are again facing uncertainty relating to AMT's impact for 2008. On June 18, 2008, the House Ways and Means Committee introduced a bill called the AMT Relief Act of 2008 in order to alleviate the wrath of this tax. With a full reform or repeal awaiting resolution with the 2008 election results, we will be left assessing whether or not we will get the true benefits of our itemized deductions.

0% Capital Gains Rate. In the 2003 Jobs and Growth Tax Relief Reconciliation Act, a zero percent tax bracket was created for qualified dividends and long-term capital gains for taxpayers in the 10% and 15% tax brackets. If you are single and your taxable income for 2008 is under \$32,551, or you are married with income under \$65,101, the zero percent rate applies to you. Many people do not qualify to take advantage of this tax rate, and with those new changes to the kiddie tax rules, their children cannot either. However, if you assist aging parents, you might consider gifting appreciated stock to them if they are in the 10% or 15% tax brackets. They could then sell the investment and qualify for the zero tax rate on the gain.

BUSINESS TAX STRATEGIES

Retirement Plans for your Business. Starting a small business retirement savings plan can be easier than most business people think. What's more, there are a number of retirement programs that provide tax advantages for both employers and employees. Experts estimate that Americans will need 70 to 90 percent of their pre-retirement income to maintain their current standard of living when they stop working.

So now is the time to look into retirement plan programs. As an employer, you have an important role to play in helping America's workers save. By starting a retirement savings plan, you will help your employees save for the future. Retirement plans may also help you attract and retain qualified employees, and they offer tax savings to your business. You will help secure your own retirement as well. You can establish a plan even if you are self-employed.

A retirement plan has significant tax advantages: Employer contributions are deductible from the employer's income, employee contributions are not taxed until distributed to the employee, and money in the program grows tax-free. Further the IRS is offering a small incentive of \$500 per year for the first three years of a new SEP, Simple, or other retirement plan to cover the initial set up expenses.

In general you may only deduct passive activity losses from passive income. You must carry any excess loss forward to the following year or years until fully offset against passive income or until you dispose of your business interest. Therefore, if you have a substantial passive activity loss carryover, you may wish to consider either disposal of the business interest to free up unused losses or consider investments in a passive activity with income. Both tax strategies will result in the reduction of taxable income.

Pass-Through Activities and Basis. Beware! Even if you are actively involved, your losses may not be deductible on your tax return if you do not have “basis.” These are complicated rules and may require an in-depth analysis by your tax professional, but there are possible solutions to correcting the problem. For instance, instead of financing the losses with loans inside the organization, the owners can finance the losses with capital contributions, even if those capital contributions are financed with bank loans directly to the owners.

These issues need to be addressed now and not on December 31 – or worse – when the returns are being prepared. It will generally take time to complete some kind of refinancing to correct a potential basis problem, and the solution must be in place by the business’ year end.

Distributions. Be careful if your pass-through entity borrows money from the bank to make distributions to you and your other co-owners. Such distributions can be taxable if you violate the basis rules. There may also be limitations placed on the deductibility of the interest expense paid by the entity on the debt. It’s important to review these types of transactions with your tax professional to be certain you have not fallen into another tax trap.

Depreciation. The Economic Stimulus Act of 2008 provided significant tax incentives for businesses to make capital investments explained below:

Section 179 - The fixed-asset expensing election under Section 179 of the Internal Revenue Code nearly doubled under the Economic Stimulus Act of 2008. The limit on expensing assets climbed to \$250,000, up from \$128,000. The deduction phases out as asset additions exceed \$800,000, up from \$510,000 in 2007. The phase out is dollar for dollar, therefore, if qualifying purchases exceed \$1,050,000 during the tax year, the business will be limited to regular depreciation rules. The limits of a Section 179 deduction for SUVs remained at \$25,000.

Bonus Depreciation - The Stimulus Act also allows for the temporary use of bonus depreciation. Companies can take **50% bonus** first-year depreciation on assets placed in service in 2008. The remaining cost is recovered through normal depreciation. Most assets depreciated over a period of 20 years or less are eligible. This includes machinery, equipment, land and leasehold improvements and luxury autos.

State Credits. Many states have income tax incentives for investing in new or existing facilities or hiring employees. If you plan to make a substantial investment in plant or people, you should discuss these ideas with your tax professional or contact the state’s revenue department to determine if tax benefits are available. The state tax benefits may be the difference in making a decision to invest in your facility. In many instances, applications must be made before the investment, so always be proactive.

Business Succession Planning – Listed last, but not least important. Summer is a great time to review or implement your plan. At its most basic, a succession plan is a documented road map for partners, heirs and successors to follow in the event of your death, disability or retirement. This plan can include a program for distribution of business stock and other assets, debt retirement schedules, life insurance policies, buy-sell agreements between partners and heirs, division of responsibilities among successors, and any other elements that affect your business assets. The plan may also establish the value of your business.

ESTATE & GIFT TAX PLANNING STRATEGIES

Estate Planning. The federal estate tax rules continue to be debated by Congress and, with the impending repeal of the federal estate tax in 2010 (for one year), it is likely Congress will make some significant changes in the next few years. In the meantime, you need to do your estate planning under current rules and regulations and be sure your estate plan is properly structured to mitigate any possible estate tax.

More importantly, you need to provide for a smooth transition of your estate to your heirs. Even if the federal estate tax is repealed or provides a high enough exemption to protect you from this tax, you need to have a written estate plan in effect. Keep in mind that many

states may still tax an inheritance even though there is little or no federal tax. You want to be sure you properly provide for your spouse and alleviate problems that can occur in the transfer of assets to your heirs.

This is a great time of the year to work on those issues. Your tax professional should be able to assist you in developing a good estate plan.

Gift Tax. The annual gift tax exclusion for 2008 is \$12,000 per person. Therefore, if you are married, you can gift up to \$24,000 per donee by using the gift-splitting rules without any federal gift tax ramifications. Gifting is a good way to reduce your taxable estate and may be important in a good estate plan.

CONCLUSION

Tax planning should not be an end-of-the-year process. Now is a great time to review steps to evaluate your current year taxes. We have covered various topics but cannot possibly address every issue relating to your specific situation. Please consult with your tax adviser before moving forward on any of these tax planning strategies. Call us today at 402.496.9100.

Now where did I put that crystal ball?