

## 2008 Year-End Tax Planning Strategies - The Time to Act is Now!

As the 2008 tax year nears an end, a short window of time remains for you to identify moves you can make before year-end to minimize your tax bill. Knowing what tax breaks are available, and how you may qualify, may help you squeeze a little lemonade from a year filled with lemons.

**Business operating losses.** In this struggling economy, many businesses are facing operating losses. Those which operate as pass-through entities, such as partnerships or S corporations, can pass those losses down to their owners. A net operating loss (NOL) deduction not only provides business owners with an offset against ordinary income, it can be applied to previous years' tax returns through the filing of amended returns for prior profitable years. This can potentially lower taxable income, increase itemized deductions, and provide a quicker tax refund.

**Income shifting.** Individuals and businesses can both benefit from the classic strategy of shifting taxable income and accelerating or deferring deductions between 2008 and 2009 by controlling the receipt of income and payment of expenses. Taxpayers expecting to be in the same or lower tax bracket in 2009 should consider

deferring income until next year and accelerating deductible expenses in 2008. Alternatively, if a substantial increase in income is anticipated in 2009 (propelling you into a higher tax bracket), income should be accelerated in 2008 and deductions deferred until next year.



**Accounting methods.** The accounting method used by a business determines when income must be recognized and expenses may be deducted for tax purposes. Cash-based businesses can shift income to next year by delaying billing notices for services or products so that payment is not received until 2009. Accrual based businesses can defer income by delaying the shipment of products or provision of services until the 2009 tax year. Sudden changes from one accounting method to another to gain a year-end tax advantage are not permitted unless it

is happenstance with a legitimate business reason for which the IRS gives its consent.

**Investment losses.** Investment losses can also generate tax breaks. The losses are known as capital losses and can be categorized as either unrealized or realized. An unrealized loss occurs whenever the market value of an unsold security falls below its cost basis. While hard to swallow, such losses do not qualify for a tax deduction. Only realized capital losses – those that happen when a security is actually sold – can result in a write-off.

Generally, capital losses are used to offset capital gains within the same holding period, i.e. short-term (owned for 12 months or less) or long-term (owned for more than 12 months). When capital losses exceed capital gains, up to \$3,000 can be deducted from ordinary taxable income, such as wages. Capital losses in excess of capital gains and the \$3,000 deduction limit are carried forward to the next year.

**Home mortgage debt.** With falling home values, foreclosures, and floods, homeowners have had little to cheer about in 2008. Fortunately, new tax laws were passed to address some of these

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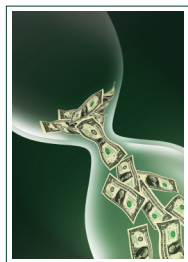
problems. For instance, the Mortgage Forgiveness Debt Relief Act of 2007 excludes from taxable income up to \$2 million of certain home mortgage debt that has been absolved. Forgiven debt is normally treated as taxable income. The new rule was extended in the recent economic stabilization law and now applies to debt forgiven in 2007 through 2012. It only covers loans incurred to purchase a principal residence. Home-equity debt used to consolidate bills or buy other items does not qualify for this exclusion.

Casualty losses. Both individuals and businesses are also allowed deductions for casualty and theft losses, as well as capital losses. Deductions by individual taxpayers for those losses, however, are limited. Casualty losses are deductible only if deductions are itemized and then subject to both a \$100 deductible per occurrence and a 10 percent adjusted gross income limitation.

Special note. EESA provides further relief to certain victims of the natural disasters that occurred this

year, such as Hurricane Ike and the severe storms, tornadoes and flooding in the Midwest. For example, the new law temporarily increases the standard deduction for individual casualty losses incurred in federally declared disaster areas and attributable to federally declared disasters, from \$100 to \$500 for tax years beginning after December 31, 2008. The deduction amount reverts to \$100 for tax years beginning after December 31, 2009.

## 2008 Expiring Provisions - Use It or Lose It!



Several tax incentives are still set to expire at the end of 2008. Since it may be "use-it-or-lose-it"

with many of these tax breaks, look carefully at whether these provisions fit into your 2008 planning scheme:

### **50-percent bonus depreciation.**

The Economic Stimulus Act of 2008 provided businesses with 50 percent bonus depreciation of the adjusted basis of qualifying property. The property generally must be purchased and placed in service during 2008.

**Enhanced expensing.** The Economic Stimulus Act also increased the amount of deductible Code Sec. 179 expensing for 2008 and increased the threshold for reducing the deduction. For property purchased and placed in service in tax years beginning in 2008, businesses can expense up to \$250,000

of Code Sec. 179 property, reduced by the value of the property over \$800,000. These levels are set to decrease for tax years beginning in 2009.

### **Modified home sale exclusion.**

Gain from the sale of a principal residence will no longer be excluded from gross income for periods that the home was not used as a principal residence (i.e. "nonqualified use"). This new income inclusion rule applies to home sales after December 31, 2008 and, under a transition rule, is based on nonqualified use periods that begin on or after January 1, 2009.

**Extended exclusion for discharges of principal residence mortgage debt.** The Mortgage Forgiveness Debt Relief Act of 2007 permitted homeowners to exclude from income tax up to \$2 million of mortgage debt forgiveness on their principal residence through 2009. The EESA extends this special relief to homeowners through 2012.

### **First-time homebuyer tax credit.**

The Housing and Economic Recovery Act of 2008 gives first-time homebuyers a temporary refundable tax credit equal to 10 percent of the purchase price of a home, up to \$7,500 (\$3,750 for married individuals filing separately). The credit begins to phase out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 in the case of a joint return). The credit is effective for homes purchased on or after April 9, 2008, and before July 1, 2009. The 2008 Economic Stabilization Act did not extend the credit.

The tax law is complex, and understanding what tax planning techniques may benefit your year-end tax planning strategy can be an overwhelming and daunting task. If you would like to discuss how certain tax planning strategies can help minimize your tax liability, don't hesitate to call our offices today.



## Temporary Tax Breaks

Many popular, but temporary, tax breaks for individuals and businesses expired at the end of 2007 or were set to expire at the end of this year. Despite their temporary nature, for many taxpayers these breaks may have become a part of traditional year-end tax-planning due to Congress's repeated extension of these benefits. Many of these tax breaks have been made retroactive to the start of 2008 and are good through 2009 courtesy of the recently enacted Emergency Economic Stabilization Act of 2008 (EESA).

Here is a partial list of popular tax breaks that may be beneficial to 2008 year-end tax planning:

**AMT patch.** The EESA provided an AMT patch for 2008 and boosts exemption amounts to help insulate most middle-income taxpayers from the AMT. For 2008, the AMT exemption amounts are:

- \$69,950 for married couples filing jointly and surviving spouses;
- \$46,200 for single taxpayers and heads of household; and
- \$34,975 for married couples filing separately.

The 2008 patch again allowed taxpayers to take nonrefundable personal credits to reduce their AMT liability. Limits in the AMT on taking personal credits against regular tax liability have also been removed.

**State and local sales tax deduction.** Individuals can deduct state and local general sales taxes in lieu of state and local income taxes. This deduction expired at the end of 2007, but the EESA makes the deduction retroactive for 2008 and extends it through December 31, 2009.

**Property tax deduction for non-itemizers.** The EESA extends the additional standard deduction for real property taxes for non-itemizers through 2009. Individual taxpayers are allowed a maximum \$500 additional standard deduction (\$1,000 for joint filers). For non-itemizers, this additional limited deduction will increase the amount of their standard deduction.

**Higher education tuition deduction.** The EESA extends through December 31, 2009 the above-the-line deduction for higher education expenses. Eligible taxpayers can deduct the costs of qualified higher education expenses and fees paid during the year for themselves, a spouse or a dependent.

**Tax-free distributions for charity.** The EESA also extends through 2009 the opportunity for eligible taxpayers to make tax-free distributions from IRAs for charitable purposes. The maximum contribution limit for 2008 and 2009 is \$100,000.

**Research tax credit.** For businesses, the EESA extends the research tax credit to amounts paid or incurred in 2008 and 2009. It also modifies the credit by increasing the alternative simplified credit,

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it sprouted and grew and flourished  
Through the strength of relationships  
with people like you.*

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*Wishing you and those important to you a happy holiday season.*

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*60 years*



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which may be beneficial to smaller businesses.

**Leasehold and restaurant improvements.** Under the EESA, qualifying restaurant improvements and leasehold improvements are eligible for 15-year cost recovery (rather than a 39-year recovery period) through 2009.

The EESA also allows a 15-year recovery period for depreciation of certain retail space improvements.

**New Markets Tax Credit.** The EESA also extends the New Markets Tax Credit through 2009. This credit is intended to encourage investment in, or loans to,

small businesses in economically distressed areas.

**Energy incentives.** The EESA not only has extended a host of energy tax incentives to consumers, producers and manufacturers, the new law also makes many favorable changes in qualifying for these tax breaks. For individuals, there is a residential energy property credit available starting in 2009; homeowners may want to delay any energy-savings improvements until 2009 as a result.

For businesses, a deduction for energy efficient commercial buildings has been extended through 2013. In addition, several incen-

tives encourage the production of renewable energy.

### Transportation fringe benefits.

The EESA also enhanced transportation fringe benefits for employers, who may now exclude transportation fringe benefits of up to \$20 per month paid to employees who commute to work by bicycle.

For more information on the Emergency Economic Stabilization Act of 2008 and other tax information, visit our website:

[www.waradydavis.com/whatsnew](http://www.waradydavis.com/whatsnew)



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