CLIENT REPORT:
2008 Year-end Tax Planning in an Uncertain Economy

Dear Client:

Year-end tax planning has taken on a news sense of urgency for many people. The downturn in the economy has everyone asking what they can do to recover from setbacks such as job and investment losses, regroup and rebound. Tax planning is always fluid and it is even more so in this time of economic uncertainty. Fortunately, there are some strategies that can give you peace of mind and confidence. At the same time, it's important to keep in mind that 2009 is likely to bring even more changes with a new Administration and Congress in Washington.

Before we take a look at traditional year-end tax planning, let's examine some of the developments that have made 2008 unlike any other year along with some possible strategies.

Stock losses. Many people have taken huge hits in their investment and retirement portfolios from the crisis in the financial markets. Not only have many stocks declined in value in recent months; others have become worthless. In today's market, you are likely to have in your investment portfolio holdings that are currently priced below your purchase price. Now might be a good time to sell those stocks or mutual funds to generate losses to offset capital gains and then up to $3,000 of your ordinary income.

Alternatively, you may want to keep a loss security in your investment portfolio. You may be able to sell the stock to recognize the loss and then reacquire it to continue your investment. However, to use the loss on your 2008 tax return, you must wait 30 days after the sale to repurchase the security. One strategy to avoid lost investment opportunities while fulfilling the 30-day rule is to purchase additional shares of the security now, especially if you anticipate that the stock price may rise during the next 30-day period. After you have held the newly acquired stock for 30 days, you can sell the original shares at a loss that will be recognized for tax purposes. Another strategy is to sell now and then reinvest the proceeds immediately in shares of a company in the same industry that are likely to perform similarly to the stock you just sold. In either case, your loss qualifies for full capital loss treatment and can offset capital gains, with any excess used to offset up to $3,000 of ordinary income.

Worthless stock also generates an immediate deduction. The rules for "worthless" stocks are very strict. Your definition of worthless may be very different from the IRS' definition. Stocks and securities must be totally worthless for a taxpayer to take a loss deduction. A mere diminution in value, no matter how great, will not trigger a loss deduction.

Retirement savings. According to the Congressional Budget Office, nearly $2 trillion in retirement savings has been lost in the last 15 fifteen months. In response, Congress may -- before the end of 2008 -- temporarily suspend the required minimum distribution (RMD) rules for IRAs and qualified retirement plans. You cannot keep funds in a retirement plan indefinitely. By April 1 of the calendar year following the year in which you reach age 70 1/2 , even if you have not retired, the remaining balance in a traditional IRA must be distributed to you in full or you must begin to receive RMDs from the account. RMDs from a qualified plan are not required until April 1 of the calendar year following the later of the year in which you reach age 70 1/2 or the year in which you retire.

Because of the recent decline in the financial market, some retirees are being forced to withdraw assets that are currently undervalued. Suspending the RMD rules would help them but would not help individuals who must take RMDs to meet their everyday living expenses. Consequently, Congress may also allow individuals to take early distributions from IRAs and other arrangements penalty-free (but still subject to income tax). Although there is some leeway for "hardship" distributions, current rules are designed to discourage early distributions. Keep in mind, however, that you are using funds today that you originally set aside for retirement. If you do not put the funds back, they won't be there for retirement.

Mortgage meltdown. The collapse of the housing market has brought about higher default rates on subprime, adjustable rate and other mortgage loans made to higher-risk borrowers. At the same time, financial institutions holding mortgage-backed assets are saddled with trillions of dollars in bad debt. The mortgage meltdown has surprised many homeowners with unanticipated tax consequences. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives part or all of the unpaid mortgage debt, the Tax Code traditionally considered the cancelled debt to be taxable income to the homeowner. In 2007, Congress gave homeowners some relief.

The Mortgage Forgiveness Debt Relief Act of 2007 and subsequent legislation excludes from taxation discharges of up to $2 million of indebtedness secured by a principal residence and is incurred in the acquisition, construction or substantial improvement of the principal residence. This special relief is available for tax years beginning January 1, 2007, and ending December 31, 2012.

This treatment also covers mortgage workouts. If a lender determines that foreclosure is not in its best interest, it may offer a mortgage workout under which the terms of the mortgage are changed to result in a lower monthly payment. This and other mortgage workouts technically would result in forgiveness of indebtedness income that would be taxable to the homeowner if it were not for the new law.

Employment. Year-end is the most common time of the year for employers to announce layoffs and job cuts. If you're uncertain about the future of your employment, you may want to liquidate some assets to have more cash on hand. You may also be able to borrow from a life insurance policy. Another way to save is to discontinue automatic contributions to retirement, investment and college savings accounts. These may be some painful steps to take but they will help shield you and your family against the financial pressures brought about by a job loss.

Along with all these concerns, there's also a host of traditional year-end tax strategies to consider. Individuals and businesses alike can benefit from the classic strategy of shifting taxable income, accelerating or deferring deductions between 2008 and 2009. The individual marginal tax rates are likely to change under the new Administration for higher-income individuals but at the same time there may be new tax incentives. There also many temporary tax breaks, which Congress recently extended, that can help minimize your tax bill along with a "patch" to help keep the alternative minimum tax (AMT) from encroaching on the middle class.

For those in business fortunate enough to have some cash on hand, now is the time to invest in the future with significant tax subsidies available for purchasing equipment at year end. These incentives range from skillful use of "half-year conventions" and other depreciation techniques to beating the deadline for 2008-only bonus depreciation and enhanced expensing. For many other businesses, the recently passed Emergency Economic Stabilization Act of 2008 also provides tax breaks that should be considered before year end. The new law extends and adds to a host of tax breaks, including the research credit, deductions for leasehold improvements, credits for efficient energy use, a deductions for giving used computer equipment and certain other business assets to charity.

We've covered a lot of information. Please contact our office so we can discuss these and many other year-end tax planning techniques.

Sincerely yours,