



TAX SAVING TIPS for 2008



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TAX PLANNING FOR 2008

Your best strategy for minimizing tax liability and bolstering your financial position is to stay current on tax law. However, in a time of sweeping change, new regulations and unprecedented economic woes, doing so can be a challenge.

In 2008, we saw tax law changes that span the full range of categories, from tax benefits for middle-income and energy-conscious taxpayers to tax relief for mortgage-strapped individuals and tax credits for parents. Yet, what remains constant is the need for in-depth knowledge when preparing your taxes.

Tax Saving Tips for 2008 provides an overview of key tax law changes that may affect your return, and the latest information and practical strategies for minimizing your tax bill.

Filing Basics

Filing Status

Taxpayers can file as single, married filing jointly, married filing separately, head of household or qualifying widow(er). If you are married and filing jointly, you can take advantage of tax credits and benefits not available to couples filing separately. Unmarried taxpayers may file as single or, if they qualify, as head of household.

Exemptions

You may claim a personal exemption for yourself, your spouse and each of your dependents. A dependent child includes not only children born to your family, but also stepchildren, foster children and adopted children. Each exemption reduces your taxable income by \$3,500 in 2008. However, you begin to lose part of the exemption benefit if your adjusted gross income (AGI) is above the following:

2008 EXEMPTION PHASE-OUT LIMITS

- Single – \$159,950 up to \$282,450
- Married filing jointly/Qualifying widow(er) – \$239,950 up to \$362,450
- Married filing separately – \$119,975 up to \$181,225
- Head of household – \$199,950 up to \$322,450

For 2008, even with AGIs in excess of the phase-out maximum, you still may take a \$2,333 personal exemption. The personal exemption reduction is being phased out and will be fully repealed by 2010.

Deductions

Even if you do not itemize, some of the following deductions may be available to you: traditional IRA, SEP and qualified plan contributions; contributions to Health Savings Accounts; one-half of self-employment tax (if self employed); alimony; job-related moving expenses; educator deduction (for teachers); and self-employed health insurance premiums.

In addition to above-the-line deductions, you can claim the standard deduction or choose to itemize your deductions. These include healthcare costs, taxes, interest, charitable contributions and other miscellaneous items such as tax return preparation fees or investment advisory fees.

The basic standard deduction for 2008 is \$5,450 if single or married filing separately, \$10,900 for married filing jointly or qualifying widow(er) and \$8,000 for head of household. Taxpayers age 65 and older and/or blind receive an additional standard deduction of \$1,050 for married filing jointly or separately, and \$1,350 for single or head of household.

The standard deduction can be increased up to \$1,000 for a joint return or \$500 for a single person, if you paid real estate taxes but choose not to itemize your deductions. In general, you should itemize if your total allowable itemized deductions are more than the standard deduction, although there are exceptions.

Keep in mind that the value of some of your itemized deductions will be reduced if your AGI is above \$159,950 (\$79,975 if married, filing separately). This reduction is being phased out until it is eliminated in 2010, and the reduction for 2008 will be lower than it was last year.

Tax Breaks for Homeowners

Interest and Property Taxes

Home mortgage interest on up to \$1 million of home acquisition loans secured by your principal residence and/or second home is fully deductible. You also may deduct mortgage interest on a home equity loan or line of credit (up to \$100,000). Points paid to secure a loan for the purchase or improvement of a principal residence usually are fully deductible in the year you pay them. Points paid to refinance an existing mortgage must be deducted over the life of the loan. Real estate taxes and state and local property taxes on all of your real estate are deductible.

Exclude Capital Gains

When you sell your principal residence, you can exclude from income up to \$250,000 in gains (\$500,000 if married and filing jointly). To qualify, you must have owned and used your home as a principal residence for at least two years during the five-year period ending on the date of sale. Limitations apply if you use the property as a rental property.

Retirement Savings Tax Breaks

Tax-advantaged retirement plans can help you lower your current tax bill and achieve a secure retirement. Recent legislation makes permanent higher IRA and 401(k) contribution limits.

Individual Retirement Accounts (IRAs)

You may contribute up to \$5,000 to fund a traditional or Roth IRA in 2008. Those age 50 or older can make an additional catch-up contribution of \$1,000. In 2009, the basic IRA contribution amount of \$5,000 will remain the same and the catch-up contribution will also remain unchanged.

Traditional IRA contributions may be deductible depending on your AGI and whether you or your spouse (if filing jointly) are covered by an employer's pension plan. Roth IRA contributions are not deductible, but the earnings accumulate tax-deferred and may be withdrawn tax-free if you meet the qualified distribution requirements.

Eligibility to contribute to a Roth IRA is phased out as AGI rises from \$101,000 to \$116,000 for single filers, and \$159,000 to \$169,000 for joint filers. Married taxpayers who file separately cannot contribute to a Roth IRA if their income is above \$10,000.

Employer-Sponsored 401(k)s

Pre-tax contributions to employer-sponsored retirement plans reduce your taxable wages. Matching contributions and income earned within your plan also are tax-deferred. The employee contribution limit for 2008 is \$15,500. Employees age 50 or older by the end of 2008 may make an additional catch-up contribution of \$5,000 for 2008. For 2009, the maximum contribution to a 401(k) plan will increase to \$16,500 and the catch-up contribution will increase to \$5,500.

Child and Education-Related Tax Breaks

Dependent Care Credit

Parents who must pay for the care of a dependent under age 13 in order to work may be eligible for a tax credit of between 20 and 35% of qualifying expenses. For 2008, the maximum amount of expenses on which the credit can be claimed is \$3,000 for the care of one dependent or \$6,000 for two or more.

This credit is not restricted to child-related care costs. If you pay someone to look after an incapacitated dependent of any age, such as a parent or disabled family member, you may be eligible for this tax break.

Education Tax Credits

Two popular credits can help defray the cost of higher education. The Hope Credit, worth up to \$1,800 for each qualifying student, is available for each of the first two years of college. A Lifetime Learning Credit of up to \$2,000 per year is available for undergraduate, graduate and professional degree courses. Both credits begin to be phased out once modified AGI surpasses \$96,000 for joint filers and \$48,000 for single filers. You cannot claim both credits for the same student in the same tax year.

529 Plans

The tax benefits of 529 college savings plans, which were to expire in 2010, are now a permanent part of the tax code. These

plans give parents and other relatives a tax-advantaged way to save money for higher education expenses. Funds in the account grow tax-free and withdrawals also are tax-free if they are used to pay for qualified educational expenses.

Tax Considerations for Investors

Long-Term Capital Gains and Dividends

The maximum tax rate on net long-term capital gains remains at 15%. For taxpayers in the 10% and 15% tax brackets, the tax rate on long-term capital gains is zero for 2008 through 2010. To qualify as a long-term capital gain, the asset must be held for more than one year before selling. Capital gains on investments held for one year or less are taxed at regular income tax rates — as high as 35%. For collectibles held for more than one year, the maximum capital gains tax rate is 28%.

Qualified dividend income from a domestic or qualified foreign company is taxed at a top rate of 15% (zero for taxpayers in the 10% and 15% tax brackets in 2008).

Offset Capital Gains with Losses

Net capital losses are fully deductible against capital gains. If your capital losses exceed your capital gains, you can deduct up to \$3,000 in net capital losses against ordinary income (\$1,500 if married filing separately). Any remaining capital losses may be carried over to the next year.

Kiddie Tax

Investors with children need to be aware that Congress has increased the age threshold of dependents subject to the Kiddie Tax, which subjects a child's investment income over a certain amount to be taxed at the parents' highest marginal tax rate. For 2008, any net unearned income over \$1,800 will be taxed at parental rates if the child is in one of these three categories: (1) under age 18, (2) age 18 and does not have earned income exceeding 50% of his/her support and (3) age 19 through 23 and is a full-time student and does not have earned income exceeding 50% of his/her support.

Other Recent Tax Law Changes

Alternative Minimum Tax (AMT) Patch

The AMT was designed to ensure equitable taxes are paid by higher-income taxpayers and is an addition to the income tax. As the AMT is not indexed for inflation, more and more taxpayers are affected by it. However, among the provisions included in the Emergency Economic Stabilization Act of 2008 is the AMT patch, which protects most middle-income taxpayers by increasing the AMT exemption amounts for 2008: \$46,200 for single filers and heads of household, \$69,950 for married taxpayers filing jointly and qualifying widows(ers), and \$34,975 for married taxpayers filing separately.

Extended Mortgage Foreclosure Tax Relief

The Mortgage Forgiveness Debt Relief Act of 2007 allowed for the exclusion from gross income up to \$2 million from the discharge of qualified personal residence indebtedness occurring in 2007, 2008 or 2009. The basis of your principal residence is reduced by the excluded amount, but not below zero. Under the Emergency Stabilization Act of 2008, this exclusion will continue through 2012.

New Energy Tax Incentives

The Emergency Economic Stabilization Act of 2008 extended the non-business energy efficient property credit of up to \$500 for the costs of making certain energy-efficient improvements to your principal residence. Examples include new exterior doors and windows, skylights, insulated walls or ceilings, and installation of a high-efficiency furnace or water heater. This credit, which expired December 31, 2007, is now available in 2009, but not in 2008.

The new law extends the 30% credit for installing residential alternative energy efficient property in your principal residence or second home through the year 2016. Qualifying property includes: qualified solar water heating, solar electric, fuel cell, wind energy and geothermal heat pump property. In addition, starting after 2008, the amount of credit will vary depending on which qualified property is purchased.

In 2008, the Alternative Motor Vehicle Credit grants four separate credits for different types of energy-efficient vehicles. Your potential credit will be determined by the type of vehicle and which of the four credits applies. You can check with your CPA or the IRS for a list of qualified vehicles and allowable credits.

Enhanced or Additional Child Tax Credit

For 2008, the Child Tax Credit is worth \$1,000 for each qualifying child who is under age 17 at the end of the calendar year and who qualifies as a dependent. For 2008, the child credit begins to phase out when modified AGI exceeds \$110,000 for married couples filing jointly, \$55,000 for married taxpayers filing separately, and \$75,000 for single filers, heads of households and qualified widows(ers). The credit is reduced by \$50 for each \$1,000, or fraction thereof, of AGI above these thresholds.

Disaster Area Tax Relief

Through the Housing and Economic Recovery Act of 2008, the IRS has created special tax law provisions that help eligible homeowners, specifically those who received federal reimbursement grants stemming from Hurricanes Katrina, Rita or Wilma, recover financially from disaster.

The new law gives those homeowners the option of adjusting (on an amended return) their previously claimed deductions by treating these grants as reimbursement for the losses they suffered on their principal residence.

To qualify, amended returns need to be filed by July 30, 2009, and any resulting tax due paid by July 30, 2010 and, in most cases, penalty and interest free.

Obtain Professional Advice

A CPA tax professional understands the business of taxes and finances, and can review your overall financial picture to help you identify winning tax strategies.

COMMON DEDUCTIONS

Above the Line Deductions

- Teacher classroom expenses
- Student loan interest
- Alimony expenses
- One-half of self-employment tax
- IRA contributions and one-half of contributions to SEP, SIMPLE and qualified plans
- Health savings account contributions
- Moving expenses
- Penalties on early withdrawals from savings accounts
- Tuition and fees deductions

Itemized Deductions

- Mortgage interest including interest on equity loans up to \$100,000
- Points paid for mortgage or refinancing
- State and local income taxes and personal property taxes
- Health insurance costs and medical expenses in excess of 7.5% of adjusted gross income
- Prescription eyeglasses, contacts and hearing aids⁵
- Crutches, canes and orthopedic shoes⁵
- Medical transportation⁵
- Cost of alcohol or drug abuse treatment⁵
- Charitable contributions — cash, property, donated clothing or household items and appreciated long-term assets
- Mileage and expenses associated with volunteer work
- Unreimbursed casualty and theft losses
- Income tax preparation software and fees*
- Job-search expenses*
- Investment expenses*
- Unreimbursed employee business expenses*
- Professional investment advisory fees⁵

⁵ Deductible to the extent the total of all medical and dental expenses exceeds 7.5% of AGI

* Deductible as miscellaneous itemized deductions to the extent the total exceeds 2% of AGI

