

# CLEMENT & ASSOCIATES

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### 2008 TAX LAW CHANGES & UPDATES

#### Can Capital Gains Rates Really be at 0%?

Yes, there really is a Santa Clause—that is if you can keep your taxable income fairly low and really do have some long-term capital gains. Long-term capital gains (some items excluded) will not be taxed by the IRS in 2008, 2009 & 2010 if your taxable income is below the top end of the 15% tax bracket, which for 2008 is \$65,100 (\$32,550 for single individuals). Most states, however, will still tax capital gains!

Congress reduced long-term capital gains rates in 2003 for stocks, bonds, mutual funds, real estate, and business assets. Long-term capital gains, for those who are in the 25% and higher bracket, are taxed at a maximum rate of 15% and apply to installment sale payments as well. By the way, if Congress takes no action before 2010, the rates are set to go back to the 10% and 20% rates which were in effect back in 2002.

I cannot emphasize enough that these are the lowest rates we have ever seen for capital gains and who knows what will happen with a new President and a change in Congress. Take advantage of these low rates to sell assets which have gains and which you are ready to sell. Don't hold back on selling just because you will be taxed as we never know how long we will have these low rates. Many of you have significant losses which can be used to lower your total tax. However, if your losses are small, try the strategy discussed in the tax planning section.

The excluded items are art, antiques, gems, stamps, coins, and other collectibles, which are taxed at a 28% maximum rate and depreciation recapture on real estate is taxed at up to 25%.

#### Maybe Not!

While Congress reduced the tax on long-term capital gains, they still left intact the law relating to the Alternative Minimum Tax (AMT).

If your income exceeds \$69,950 (\$46,200 for singles) and includes a significant amount of capital gains and dividend income taxed at the 15% rate, you may be subject to the AMT.

When income exceeds \$150,000 (\$112,500 for singles), certain exemptions begin to phase out and you will more than likely pay the AMT.

#### Capital Gain Exclusion on Sale of Residence

Congress decided to change the rules for those converting a rental to their primary residence. If you acquired a rental property using a 1031 (tax-free) exchange and convert it to a primary residence, you must hold the home for more than 5 years to take advantage of the \$250,000 per person exclusion.

Effective in 2009, if you convert a rental property into your primary residence, the gain occurring while the property was a rental will be taxed and only the gain occurring while the property is your primary residence can qualify for the \$250,000 per person exclusion.

#### Convert Home to Rental to Take a Loss? - No!

Thinking about converting your home to a rental property because you now have a loss on it or cannot sell it and need to move? The IRS only allows you to claim a loss on the sale of a rental or investment property based on the value of the property at the time it was converted to a rental. If you paid more for the home than it is now worth, the IRS requires you to determine its value at the time you converted it to a rental. This is the value used to calculate depreciation and a loss when it is sold. Your best plan of action is to get an appraisal at the time the property is converted.

#### Debt Forgiveness – Is it Taxed or Not?

The IRS normally requires you to pay tax on any debts that are forgiven. This includes credit card debt written off as well as the unpaid portion of a home loan when there is a short sale or the home is sold in foreclosure.

There is an exception to this requirement to pay tax on forgiven debts. The exception is when your debts exceed your assets (insolvency), you file bankruptcy, or a few other exceptions.

Effective for 2007, 2008, and 2009, Congress created an exception to this rule for debt forgiven when it is your primary residence and it is acquisition indebtedness. If you have refinanced your home and have not used all of the proceeds to make improvements to the home, then part of the loan is not considered acquisition debt and you will pay tax on that portion of the forgiven loan unless you meet the normal exceptions mentioned in the previous paragraph. If you are in this situation, please call us so that we can review the details with you as this can become very complicated. We will need copies of the most current loan statement(s) and escrow closing

statements for the initial purchase as well as the loan refinancing.

### **Help for Homeowners Who Owe too Much!**

Congress passed a bill mid-year that allows FHA to replace current mortgage loans with 30 year fixed rate loans for up to 90% of the home's present value. Your lender will have to forgive any loan amount in excess of 90% of the home's value. You may not have heard much about this as it was to begin in October, 2008.

To qualify, this must be your primary home, you must have spent more than 31% of your monthly income on your mortgage payments as of March 1, 2008, and the loan must have been in place in 2007.

There is a catch! During the first year, any equity goes to the FHA if the property is sold. Each year thereafter, your share of the equity increases by 10%, capping at 50% after year 5.

### **Credit for First Time Home Buyers**

Congress created a limited incentive for first time home buyers. You can claim a refundable tax credit equal to 10% of the purchase price of a new home up to \$7,500 if purchased between April 8, 2008 and June 30, 2009.

As always, there is a catch. This is really a loan which must be paid back over 15 years. The good news is that there is no interest. When the house is sold, the unpaid portion of the "loan" must be paid back at the time the sale is reported on your tax return.

### **Alternative Minimum Tax (AMT)**

These words continue to be some of the most unbearable in the tax lexicon. Congress created an alternate way to calculate the tax due for all returns with Adjusted Gross Income exceeding \$69,950 (\$46,200 for singles) for 2008. In 2009, the AMT exemption drops back down to \$45,000 (\$33,750 for singles) unless changed.

The AMT allows you deductions for "qualified" home mortgage interest, charitable contributions, and almost nothing else. Deductions for State income taxes, property taxes, business expenses, personal exemptions, as well as credits for children, childcare, or other credits are ignored. Then the tax is calculated at a flat rate of 26-28% on all income in excess of \$69,950. If this exceeds your regular tax, you pay the higher amount.

"Qualified" home mortgage interest is that which is used to build, buy, or improve your principal or qualified second residence. If the interest is on a refinanced loan or equity loan taken out for other reasons (i.e. auto purchase or to pay down credit cards) it is disallowed for AMT purposes. This is an issue both in calculating AMT and other new tax laws and we will have to ask for copies of escrow statements on all loans

as well as more detail on how you used your loan proceeds in the future.

If Congress had not passed an AMT patch in October to increase the exemption in 2008 to the above amounts, most of us would be paying an additional \$5,000 or so in taxes this year. If you have the opportunity to communicate with your Congressional Representative or Senator, please do so and indicate your displeasure with their lack of making a permanent decision on the matter. By the way, if you find the entire concept of AMT confusing, you are not alone! Let your Congressional Representative or Senator know that as well!

If you have significant capital gains this year, want to prepay your property taxes, or plan to claim a significant amount of investment or business expenses on Schedule A, please call us before making last minute deductions as part of your year-end tax strategy.

### **Not Itemizing? Claim Property Tax Deduction**

Another good deduction was passed into law for 2008 only. If you claim the standard deduction and pay property taxes, you can claim up to \$1,000 (\$500 for singles) in addition to the standard deduction.

### **Section 179 Write-Off & Bonus Depreciation**

Small businesses that purchase less than \$500,000 of equipment are normally allowed to write-off up to \$128,000 worth of equipment. For 2008 only, the Section 179 write off has been increased to \$250,000 if they purchase less than \$800,000 of equipment. This still includes trucks or SUV's with a gross vehicle weight (loaded weight) of 6,000 lbs or more, with a cap of \$25,000.

Remember that you will only get a write-off for the business use percentage, not 100% of the truck or SUV and only to the extent that you have a profit in your business. Even if one does not claim the quick write-off of a qualifying truck or SUV, the vehicle can still be written off over 5 years in its entirety with no limitations, rather than the \$16,000 maximum over the first 5 years. While this is available for your Federal return, some states limit or do not allow this write-off.

Bonus depreciation is back for 2008 only. We are allowed to write off 50% of equipment and some leasehold improvements. This bonus depreciation is also allowed for automobiles, but is limited to \$8,000 plus the normal depreciation of \$2,960 for a total first year deduction of \$10,960.

### **IRS Mileage Rate Way Up for Part of 2008**

The IRS mileage rate for 2008 started out at 50.5 cents per mile, increased to 58.5 cents on July 1, and decreases to 55 cents per mile in 2009. Medical and moving mileage started out at 19 cents, increased to 27

cents per mile on July 1, and decreases to 24 cents per mile in 2009. Charitable mileage remains at 14 cents per mile for 2008 and 2009 as Congress did not allow for cost of living adjustments.

### **Electric Vehicle & Energy Tax Credits**

Congress is going to encourage us to begin purchasing plug-in electric vehicles. Beginning in 2009, one can receive a credit of up to \$7,500 for purchasing one of these vehicles. The minimum credit is \$2,500 for vehicles powered by a 4-kilowatt hour battery and a \$417 credit is added for every additional kilowatt hour of battery power up to the maximum. This credit can go as high as \$15,000 for purchasing a vehicle over 10,000 lbs gross vehicle weight.

Have you been considering installing a solar energy system in your home? There is currently a credit equal to 30% of the purchase price, but with a cap of \$2,000. This cap is now eliminated beginning in 2009 which allows the credit to be much higher. In addition, beginning in 2009 tax credits will be given for the installation of wind energy and geothermal heat pump systems in your home.

### **Health Savings Accounts Becoming Popular**

Congress created a medical deduction similar to an IRA in that it allows us to claim a deduction for medical expenses above the line. It does require some extra steps that may be worthwhile looking into.

It will allow you to deduct preventive care and over-the-counter medicine and supplies (i.e. Band-Aids and Aspirin). It does require you to have a medical insurance plan, either through your employer or purchased on your own, with a deductible of at least \$1,100 for an individual, \$2,200 for a family and is not available for those participating in Medicare.

The concept is to allow you to invest in an IRA like account (HSA). This amount is available for you to reimburse yourself for almost any medical expenses except for health insurance premiums. A number of insurance companies and banks have teamed up together to make these HSA's work smoothly. There are reporting requirements on your tax return, but that is easily taken care of if you make us aware that you are participating in an HSA.

The maximum amount one can contribute to an HSA is \$3,000 in 2009 (\$2,900 for 2008) for an individual or \$5,950 (\$5,800 for 2008) for a married couple. A positive aspect of this is that money contributed to the HSA can be carried over to future years with no limits, and if you turn 65 and begin participating in Medicare, you can withdraw the funds like an IRA. If, however, funds are withdrawn before age 65 for any purpose other than medical expenses, it is not only subject to tax, but also a 10% penalty as well.

Look at [www.hsainsider.com](http://www.hsainsider.com) for good information about HSA's including costs and deductibles of some specific plans. Compare the savings on the reduced premiums for your health insurance with the added cost you will be responsible for with the higher deductibles.

### **IRA/Retirement Plans—Maximize Contributions**

Many of you are asking me if you should still contribute to an IRA or retirement account since the value of your accounts have dropped. The answer is yes, but you do not have to invest in stocks or mutual funds. You can invest in CD's and other investments. Call us about where you can invest your retirement accounts if you have questions.

All or part of your Federal tax refund may be direct deposited into a qualifying IRA account. In addition, you can continue to make a donation directly from an IRA to a charity, but no deduction will be allowed.

Employers are now offering Roth 401(k) plans which operate similar to a Roth IRA. The advantages to Roth 401(k) plans, just like a Roth IRA, is that your earnings will grow on a tax free basis and will not ever be taxed on the growth if you hold the fund for at least 5 years and withdraw the funds after you are 59 ½. If you need to withdraw funds for college tuition or to purchase a home before age 59 ½, you can withdraw original contributions without tax or penalty, so long as you do not withdraw any of the earnings.

The maximum contribution to a Roth or Traditional IRA increased to \$5,000 for 2008 and 2009. If you are not currently contributing to a Roth IRA, begin thinking very seriously about it. If you are over 50, you can increase the maximum contribution to your IRA by an additional \$1,000.

If you are in a 401(k) plan, a 457 plan, or a 403(b) plan, your maximum contribution is \$15,500 for 2008 and \$16,500 for 2009. If you are over 50, you can add \$5,000 to the maximum contribution in 2008 and \$5,500 in 2009.

Contributions to a profit sharing plan for small businesses are now 25% of compensation or 100% of an employee's earnings, up to a maximum of \$46,000 (\$49,000 in 2009) if a "Defined Contribution Plan" is established.

Employees participating in a SIMPLE IRA can contribute up to \$10,500 from their paychecks for 2008 and \$11,500 for 2009. Those age 50 and older can increase this amount by \$2,500 in both 2008 and 2009.

### **IRS Audits & Notices**

The IRS and many states are sending out a lot of notices trying to collect additional taxes. If you receive any

notices, please fax or scan both sides of the notice ASAP and then call us. We can usually tell very quickly what the issue is if we have the notice in front of us and it saves all of us time.

### **Employee or Subcontractor?**

Many of you own a business and hire subcontractors or pay commissions or rents during the year. We need to remind you that if you make payments totaling \$600 or more to any one person, attorney, or unincorporated business, you must prepare and file a 1099-MISC which must be filed with the IRS by the end of February. We believe this will be a major focus of the IRS and encourage you to prepare these forms. If you need assistance, give us a call.

### **Foreign Bank Account Reporting**

The IRS wants to keep closer tabs on foreign accounts of US taxpayers. There is a reporting requirement if you have \$10,000 or more in a foreign account. You must also file Form 90.22-1 by June 30 and submit a detail of your foreign accounts.

### **FTB - Mandatory E-Pay Requirements**

California is broke! So what do they do, but accelerate revenue. One way is to require electronic payment by anyone who pays \$20,000 or more in a single estimate payment or whose liability is \$80,000 or more. Be aware it goes into effect next month, January 1, 2009!

## **TAX PLANNING STRATEGIES**

Tax planning should be done throughout the year, not solely at year end. Unless you will be impacted by the AMT (in which case the recommendations are usually reversed), it is often beneficial to accelerate all possible deductions into the current year.

**Contribute the maximum possible** to a 401(k) plan, Tax Sheltered Annuity, Deferred Compensation Plan, SEP, and/or IRA (preferably a Roth IRA). Those who acquaint themselves with our philosophy of financial planning understand the long-term value of investing the maximum possible in such a plan. An added plus is that your employer will often match your contributions. This can double your contribution and maximize your future earnings.

In fact, you should contribute to a Roth IRA even if you have a 401(k), SEP, IRA, or 403(b) plan at work. Unless your income exceeds \$101,000 for a single individual (\$159,000 for a married couple) or you file as married filing separate, take advantage of the Roth IRA.

**Shift income to children** when taxable income exceeds \$67,900 for a married couple in 2009 (\$33,950 for singles). Children under 18 can make \$1,800 of unearned income (i.e. interest, dividends, and capital

gains) before having to pay tax at their parent's rate. Children under 18 can also be paid a wage from their parents business (proprietorship or partnership only) and earn up to \$5,450 without paying taxes as long as they have no unearned income. In addition, their parents need not pay social security or unemployment taxes on those earnings.

Don't forget about the ability to make gifts, now at \$12,000 for 2008 (\$24,000 for couples) per year to as many individuals as you desire. This annual exclusion increases to \$13,000 in 2009 for each person. This provides a way to transfer assets to your children. You also have a combined lifetime estate and gift tax exemption up to \$2,000,000 for 2008 and increasing to \$3,500,000 in 2009, in addition to the annual gift.

Be aware, there is a potential conflict with shifting income to children. If you are trying to qualify for college scholarships or loans, 35% of a student's assets must be considered available to pay tuition and reduces the ability to qualify for grants and low interest loans. Less than 6% of parents' assets are considered.

**Alternate capital gains and capital losses.** Sell stocks with gains one year and those with losses in different years, so long as the losses are no more than \$3,000 and you are in the 25-35% brackets. Capital losses up to \$3,000 can be written off against ordinary income taxed at maximum rates. Capital gains on the other hand are taxed at a maximum rate of 15%.

If you have significant capital losses, then take those losses in a year with significant capital gains so that you can realize the benefit of the losses. This way you will be allowed to deduct losses equal to the amount of capital gains in that year, plus \$3,000. If the stock is worthless, sell it to an unrelated party for \$1 and document the sale. Do not repurchase the same stock within 30 days as the loss will be disallowed.

**Sell real estate on the installment sale method** if you want to receive cash from the sale. Installment sales require only that you receive payment in at least two different years. You are taxed on the profit prorated by the cash received in each year. Be aware that in the year of sale, the IRS requires total payments to be reported, not the net cash you received. Also any depreciation recapture is taxed in full in the year of sale. One caveat to be aware of—if Congress changes the capital gains tax rules, all capital gains received after the date of the change will be taxed at the new rate.

**Selling real estate? Do a tax-deferred exchange.** A 1031 exchange can postpone tax on the sale of real estate until you sell the property received in the exchange. There are strict time requirements and limits on how you must handle debt and the proceeds from the sale. In addition it will cost \$1-3,000 in accommodator and professional fees to handle the exchange.

### **Accelerating Deductions**

Consider the following **unless you will be affected by the Alternative Minimum Tax.**

**Pay your January 1 mortgage payments** for your home and rental properties by Christmas to enable the lender to receive and record the payment by December 31. Unless the lender receives and records the payment by December 31, they will report the payment of interest in the following year.

**Accelerating contributions** from next year into this year can be a very profitable move. This is one area Congress has never really touched, other than requiring receipts from the charity. Take full advantage of donating to your favorite charity. This includes the clothing and other goods that should be donated by December 31. Do remember to obtain a receipt for any food or clothing donated.

**Bunch your medical expenses** every other year unless they exceed 7.5% of your AGI by a significant amount each year. For example, if you are making payments for orthodontia work, prepay as much as possible in the current year.

**Prepay next year's property taxes** by December 31 if they are due within the first four months of the year.

**If miscellaneous deductions exceed 2% of your AGI,** (i.e. \$1,000 for an AGI of \$50,000) accelerate all possible expenses into the current year. Most of our clients have sufficient job related expenses, investment deductions, and other deductions (including job-search expenses, continuing education, and tax preparation fees) to make it well worth your while to accelerate those expenses into this year.

**Pay 4th quarter state income tax estimates** by December 31. This estimate is due on January 15. By paying 15 days early, you receive the deduction a year earlier. This does not apply to the Federal estimate.

### **THIRD-PARTY SERVICE PROVIDERS**

Clement & Associates uses third-party service providers to provide professional services for our clients. If you should have any questions concerning this disclosure, please feel free to contact Steve and he will be happy to answer any questions you may have. This notice is in compliance with professional standards established by the American Institute of Certified Public Accountants (AICPA Professional Standards ET Sections 191.224-.225 & 291.023-.024).

### **LENDER LETTERS**

We have prepared many lender letters and forwarded copies of tax returns and other financial information to lending institutions. This year the IRS has put stricter regulations on third-party disclosure. Because of this we will only be able to forward copies of tax returns to you directly. We furnish a hard copy of your tax return to you and will, at your request, email a pdf copy for your convenience.

### **IS YOUR EMAIL ADDRESS CORRECT?**

During tax season, Steve will usually return emails when he cannot return phone calls due to the time constraints of his appointment schedule. Please make sure we know your current email address when you return your appointment card or the next time you call us if we do not currently have it on file or it has changed. You can reach us at the following email addresses:

Dawn Henry (Appointments, status of returns)  
Pattie Hagen (Accounting/tax questions, missing info)  
Jeremy Craig (QuickBooks® accounting & business tax returns)  
Steven Clement (Tax/QuickBooks®/financial planning questions)

[Receptionist@clementcpa.com](mailto:Receptionist@clementcpa.com)  
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### **WEB PAGE, NEWSLETTER, AND CHECKLISTS**

Have you checked out Tax Tools on our web page at [www.clementcpa.com](http://www.clementcpa.com) lately? We have an interactive worksheet for Non-Cash Contributions and other helpful checklists under Tax Tools. We are also sending out a monthly newsletter via email. If you have not begun receiving this newsletter by the time we meet for your tax appointment, please let us know.