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To Our Clients and Friends,

As we approach year-end, it's again time to focus on last-minute moves you can make to save taxes—both on your 2007 return and in future years. Before we get to specific suggestions, remember that effective tax planning requires considering both this year and next year—at least. Without a multiyear outlook, you can't be sure maneuvers intended to save taxes on your 2007 return won't backfire and cost additional money in the future.

AMT Makes It a Whole New Ball Game

Individuals must compute their income taxes under two systems—the regular tax system and the so-called alternative minimum tax (AMT) system—and pay the higher of the two amounts. When introduced many years ago, the AMT targeted and normally only applied to high-income taxpayers who benefited too much from certain tax breaks. Today, however, virtually no taxpayer can ignore the AMT. Therefore, the first step in tax planning is to assess your exposure to AMT. Tax planning for AMT is often dramatically different than planning for regular tax. In fact, it's sometimes backwards.

Who is at the highest risk for AMT? Many taxpayers can fall into AMT, but those who deduct a significant amount of state and local taxes (income, property, and/or sales taxes) or miscellaneous itemized deductions (like unreimbursed employee business expenses), or claim multiple dependents are especially vulnerable. Those who recognize a large capital gain or exercise incentive stock options during the year are also vulnerable. If you suspect AMT might be an issue, please contact us so we can plan accordingly.

Now that we've addressed the AMT, let's move on to a variety of tax planning strategies that apply to the vast majority of taxpayers—that is, those in a regular tax situation.

Strategies That Never Go Out of Style

Manage Your Adjusted Gross Income (AGI). Many tax breaks are only available to taxpayers with AGI below certain levels. Some common AGI-based tax breaks include the child tax credit (phase-out begins at $110,000 for married couples and $75,000 for heads-of-households), the $25,000 rental real estate passive loss allowance (phase-out range of $100,000–$150,000 for most taxpayers), and the exclusion of social security benefits ($32,000 threshold for married filers; $25,000 for other filers). In addition, taxpayers with 2007 AGI in excess of $156,400 begin losing part of their itemized deductions. Accordingly, strategies that lower your income or increase certain deductions might not only reduce your taxable income, but also help increase some of your other tax deductions and credits.

Defer Income and Accelerate Deductions. Due to the time value of money, it's better to pay taxes later rather than sooner (assuming your tax rates won't be appreciably higher next year). Therefore, strategies that defer income from the current year to later years and those that move deductions from later years into the current year are always popular. How do you shift income and deductions between tax years? The most common techniques are using income or deductions that you can easily control.

For example, cash-basis sole proprietors might delay year-end billings so that they fall in the following year. Of course, before deferring income, you must assess the risk of doing so. On the investment side, income from short-term (i.e., maturity of one year or less) obligations like Treasury Bills and short-term CDs is not recognized until maturity. Income from those straddling year-end is deferred to the following year. For sales of property, an installment sale will shift part of the gain to later years when the installment payments are received.

On the deduction side, you can move charitable donations you normally would make in early 2008 to the end of 2007. If you're temporarily short on cash, charge the contribution to a credit card—it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or

state income taxes otherwise due in early 2008. But, watch out for AMT, as these taxes are not deductible for AMT. If you own a cash-basis business, you can accelerate payment of certain expenses, such as office supplies and repairs and maintenance, to 2007.

Watch Out for New Stricter Rules for Charitable Contributions

For 2007, you cannot deduct any cash contribution unless you retain either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets tax-law requirements. For cash donations of $250 or more, a bank record is not enough. You must obtain a charity-provided statement that meets tax-law standards. Also, you cannot deduct donations of used clothing and household items unless they are in good used condition or better. This includes furniture and furnishings, electronics, appliances, linens, and the like. Be sure to keep a list and photo (to help establish the item's condition) of donated items.

Kiddie Tax Alert: Will Your Child Be 18 or Older at Year-end?

When the Kiddie Tax hits part of your child's unearned income (typically from investments), it gets taxed at your higher marginal rate rather than at your child's lower marginal rate. For 2007, the Kiddie Tax won't affect a child who is age 18 or older as of year-end. Next year, however, the Kiddie Tax can hit part of the unearned income of a child who will be age 18 and a full-time student who will be age 19–23 as of 12/31/08 if the child's earned income (such as, wages) for the year does not exceed half of his or her support.

As you can see, your child could be exempt from the Kiddie Tax this year (because he or she will be 18 or older at year-end), but not next year (because he or she will be a student age 19–23 without sufficient earned income). In this scenario, consider having your child trigger some taxable gains and investment income this year. They will be taxed at your child's lower rate. Next year, that might not be true due to the new Kiddie Tax age rules. Keep in mind that, for this year, the Kiddie Tax only hits unearned income in excess of $1,700. The threshold is expected to be $1,800 for 2008. Also, salaries and wages are not subject to this tax.

Strategies Involving Your Securities

Harvesting Capital Losses. There's no question that this year the stock market has had its ups and downs. If you are sitting on some investments that have dropped in value since you acquired them, now might be a good time to dump part or all of them to cut your tax bill. You can deduct capital losses up to the amount of any capital gains that you'll have for the year (for example, from mutual fund distributions or sales of stocks or bonds). Also, you can claim up to an additional $3,000 of losses ($1,500 if you're married but filing a separate return) against your other income. Any losses in excess of these amounts carry over to next year.

If you're selling less than your entire interest in an investment, you can maximize the amount of deductible loss that you realize by telling your broker or mutual fund company to sell the highest basis shares first (and then have them confirm your instructions in writing within a reasonable time after the sale). In addition, if you think your investments that are currently underwater are poised for a comeback, you can buy them back after taking a loss as long as you don't reacquire them within 30 days before or after the sale.

Timing Long-term Capital Gains (LTCGs). As you evaluate investments held in your taxable accounts, consider the impact of selling appreciated securities. For 2007, regular federal income tax rates can go as high as 35%, whereas the federal tax rate on LTCGs is 15% (it's 5% if you're in the 10% or 15 % regular tax brackets). The preferential LTCG rates are only available for securities held for over one year. Therefore, holding appreciated securities for over a year before selling makes great tax sense. That said, now may be a great time to cash in some long-term winners to benefit from the historically low tax rates.

However, if you expect to be in the 10% or 15% regular income tax bracket for 2008, you might benefit from postponing LTCGs until 2008 when your tax rate on LTCGs will be 0%—it doesn't get any better than that. For 2008, your tax bracket won't go over 15% (so your LTCGs will be taxed at 0%) if your taxable income (including your LTCGs) doesn't go over about $65,000 if you're married and file jointly ($32,000 if you're single).

Give Appreciated Securities to Your Child (or Grandchild). A great way to reduce the tax hit on an appreciated security is to give it to your child or grandchild. The child can hold the security until a year when the Kiddie Tax doesn't apply and then sell. (Take care to avoid the new Kiddie Tax rules that will kick in next year.) The resulting capital gain may well be

taxed at 0% if the sale takes place in 2008–2010 (assuming the current rate structure is left in place). For example, in 2008, the 0% LTCG rate will apply if the child is single, isn't subject to the Kiddie Tax, and has taxable income below $32,000.

Remember that giving the security to your child is considered a gift. However, you can use your annual $12,000 gift tax exclusion to shelter the transaction from any gift tax. For larger gifts, you can use up part of your $1 million lifetime gift tax exemption to avoid any gift tax hit. However, dipping into your $1 million exemption could result in a higher estate tax bill after you die.

Take Advantage of the Deduction for State Sales Taxes Before It Becomes History

The optional deduction for state and local sales and use taxes (in lieu of deducting state income taxes) will expire at the end of this year unless Congress takes further action. If you live in a state with low or no state income tax and plan on making big-ticket purchases (such as a new car or boat) in the near future, you may want to go ahead and make them before year-end to cash in on the sales tax break for 2007.

Strategies for Seniors Age 70 ½ Plus

Retirement Plan Distributions. If you're age 70½ or older, you're normally subject to the so-called minimum distribution rules with regard to your retirement plans (other than Roth IRAs). Under these rules, you must receive at least a certain amount each year from your retirement accounts. You can always take out more than the required amount, but anything less is subject to a 50% penalty on the shortfall amount.

If you turned age 70½ in 2007, you can delay your 2007 required distribution to 2008 if you choose. But, waiting until 2008 will result in two distributions in 2008—the amount required for 2007 plus the amount required for 2008. While deferring income is normally a sound tax strategy, here it results in bunching income into 2008. Thus, think twice before delaying your 2007 distribution to 2008—bunching income into 2008 might throw you into a higher tax bracket or have a detrimental impact on your other tax deductions.

Charitable Donations from IRAs. If you've reached age 70½, a law change from last year allows you to arrange to transfer up to $100,000 of otherwise taxable IRA money (including your required minimum distribution) to specified tax-exempt charities. Such a transfer is federal-income-tax-free to you, but you don't get to claim it as an itemized deduction on your Form 1040. However, the tax-free treatment equates to a 100% write-off, and you don't have to itemize your deductions to get it. Additionally, as a write-off, it may reduce your Social Security benefits subject to tax. Be careful—to qualify for this special tax break, the funds must be transferred directly from your IRA to the charity. Also, this favorable provision will expire at the end of this year unless Congress extends it. So, this could be your last chance.

IRA Planning

Don't forget to make your 2007 traditional or Roth IRA contributions as soon as possible, but definitely before the due date (4/15/08) of your tax return. Except in the case of the Roth IRA, the earnings in retirement accounts are technically tax-deferred, not tax-free. However, funding them as soon as possible allows you to defer more taxes for 2007. Thus, you benefit by keeping more funds invested for a longer period of time.

For 2007, combined Roth and traditional IRA contributions generally can be made up to the lesser of (1) $4,000 ($5,000 if age 50 or older by the end of 2007) or (2) 100% of compensation. Compensation includes wages, salaries, other amounts derived from or received for personal services actually rendered including self-employment income, and alimony. For married couples, IRA contributions up to $4,000 ($5,000 if age 50 or older by the end of 2007) can be made for each spouse if the combined compensation of both spouses is at least equal to the contributed amount and they file a joint return.

If neither you nor your spouse (if you're married) are active participants in an employer-maintained retirement plan, traditional IRA contributions are fully deductible. Otherwise, the amount of the traditional IRA contribution that is deductible will be limited when your AGI exceeds certain limits.

Roth IRA contributions are never deductible. Nevertheless, it's hard to beat a Roth IRA because of the availability of tax-free distributions if you satisfy certain conditions, the lack of mandatory distributions at age 70½, and the option of withdrawing your contributions tax-free and penalty-free at any time. Unfortunately, Roth IRA contributions

are not allowed once your AGI exceeds $166,000 if you're married and file jointly or $114,000 if you're not married. If you have earned income, but don't qualify for a Roth IRA or a deductible traditional IRA, you may still want to make a nondeductible contribution to a traditional IRA to take advantage of the tax deferred growth such accounts provide. Also, starting in 2010, all taxpayers will have the option of converting their traditional IRAs to Roth IRAs (Currently only taxpayers with AGI of $100,000 or less can convert a traditional IRA to a Roth IRA.).

Go Green and Reap Tax Savings

Nonbusiness Energy Property Credit. This credit is generally limited to a lifetime amount of $500, although other limits may also apply. Basically, the credit is (a) 10% of what you pay for qualified energy efficiency improvements (such as certain energy efficient insulation, windows, doors and roofs), plus (b) 100% of what you pay for qualified residential energy property (such as certain energy efficient heat pumps, hot water heaters or boilers, and advanced main air circulating fans) on your principal residence (no vacation homes). If you're going to go green, now may be the time—unless extended by Congress, this credit won't apply to purchases made after 2007.

Hybrid Vehicle Credit. If you are considering a hybrid vehicle purchase in the near future, please give us a call. The IRS is constantly updating the list of vehicles that qualify for tax credits, which can go as high as $3,400. However, this credit is not allowed for alternative minimum tax. It is also phased out after the manufacturer records the sale of the 60,000th hybrid vehicle. Under this rule, Lexus and Toyota purchases made after 9/30/07 are not entitled to any credit. If you're considering another manufacturer's hybrid, you may want to act fast before it reaches this limit (assuming AMT is not an issue).

Tax Planning at the Office

401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

Cafeteria Plan Flexible Spending Accounts (FSAs). If your company has an FSA, before year-end you must specify how much of your 2008 salary you wish to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying child care costs. One word of caution, though, FSAs are "use-it-or-lose-it" accounts. Thus, you don't want to set aside more in such an account than what you'll likely have in qualifying expenses for the year.

Married couples who both have access to an FSA will also need to decide whose FSA to use. If one spouse's salary is likely to be higher than what's known as the FICA wage limit (which is $97,500 for this year and will be somewhat higher next year) and the other spouse's will be less, the one with the smaller salary should fund as much of the couple's FSA needs as possible. The reason is the 6.2% social security tax levy stops at the FICA wage limit (and doesn't apply at all to money put into an FSA). Thus, for example, if one spouse earns $110,000 and the other $40,000 and they want to collectively set aside $5,000 in their FSAs, they can save $310 (6.2% of $5,000) by having the full amount taken from the lower-paid spouse's salary versus having 100% taken from the other one's wages. Of course, either way, the couple will also save approximately $1,500 in income and Medicare taxes because of the FSA.

Last but not least, if you currently have an FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: over-the-counter drugs (e.g., aspirin and antacids), new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early.

Adjusting Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2007, consider bumping up the Federal income taxes (FIT) withheld from your paychecks now through the end of 2007 so that your total tax payments (estimated payments plus withholdings) equal at least 90% of your estimated 2007 liability or, if smaller, 100% of last year's liability (110% if your 2006 AGI exceeded $150,000). When you file your return, you will still have to pay the taxes due less the amount paid in, but interest or penalties will be minimized, if not eliminated.

For Your Business

Faster Depreciation for Leasehold and Restaurant Improvements. Favorable 15-year depreciation is allowed for qualified leasehold and restaurant improvements that are placed in service by 12/31/07. Unless Congress extends this provision, the cost of these improvements placed in service after 2007 will generally have to be depreciated over 39 years. If your business is working on these types of improvements, you'll want to pull the stops out to get them done and placed in service by the end of the year.

Business Charitable Donations. Enhanced deductions are allowed for certain types of charitable donations made through 2007. There are two enhanced deductions available to C corporations—one for donations of computer equipment and software and another for qualified book contributions. Non-C corporation businesses get an enhanced deduction for donations of food inventories. Last, but not least, is a rule that provides favorable treatment for S corporation donations of certain appreciated assets. These enhanced deductions and special rules will be unavailable in tax years beginning after 2007 unless Congress extends them. If your business plans entail such donations, you'll want to complete them before the end of the year.

Employ Your Child (or Grandchild). If you are self-employed, don't miss one last opportunity to employ your child (or grandchild) before the end of the year. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child or grandchild, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. Children with IRAs, particularly Roth IRAs, have a great start on retirement savings since the compounded growth of the funds can be significant.

Remember a couple of things when employing your child or grandchild. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college or entering soon, having too much earned income can have a detrimental impact on the student's financial aid eligibility.

Conclusion

Through careful planning, it's possible your 2007 tax liability can still be significantly reduced. But don't delay. The longer you wait, the less likely it is that you'll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they're no substitute for personalized professional assistance. Please don't hesitate to call us with questions or for additional strategies on reducing your tax bill. We'd be glad to set up a planning meeting or assist you in any other way that we can.

Best regards,

Wittenberg CPA, PS