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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 2008 return and in future years. Remember that the purpose of the ideas we'll discuss in the following paragraphs are limited to achieving your personal and business financial objectives in a "tax efficient" manner. In other words, a proposed transaction normally should not only save taxes, but also make economic sense before it's a wise move.

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, in Congress' opinion, 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 or miscellaneous itemized deductions (like un-reimbursed 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.

Consider Deferring Income and Accelerating 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. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2009. You can also postpone taxable income by prepaying a reasonable amount of deductible business expenses such as office supplies and repairs and maintenance before the end of this year. Both moves will defer taxable income from this year until next year.

You might also consider moving charitable donations you normally would make in early 2009 to the end of 2008. 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 the AMT, as these taxes are not deductible for AMT purposes.

Charitable Giving Strategies

Documentation Is Key. Charitable contributions are only deductible if you have proper documentation. For cash contributions of less than $250, this means you must obtain 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, by the time your tax return is filed, a charity-provided statement that lists any significant goods or services received in return for the donation (other than intangible religious benefits) or specifically states that you received no goods or services from the charity.

Charitable Gifts of Stock. If you have appreciated stock that you've held more than a year, and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares.

However, if the stock is now worth less than you when you acquired it, sell the stock, take the loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value and no capital loss will be available.

Investment Strategies

Harvesting Capital Losses. There's no question that this has been a horrendous year for the stock market. It's likely that you are sitting on some investments that have dropped in value since you acquired them. If it otherwise makes sense, 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 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. Despite the down market, you hopefully still own some appreciated investments in your taxable accounts. If so, you may want to consider selling any that you've held for over a year that would generate long-term capital gains. The maximum federal income tax rate on most long-term capital gains from 2008 sales is only 15%. Therefore, now may be a good time to cash in some long-term winners to benefit from historically low tax rates. This could turn out to be a really smart move if capital gains tax rates go up next year—a definite possibility.

Of course, investment moves should not be made solely to capitalize on the current low capital gains rates, but if you're planning to sell sometime in the near future, sooner may be better than later. For example, now may be a good time to diversify a large holding of stock you've held for over a year. The stock's value may be down, but that is also true of most other securities. Your investment dollars could then go to scooping up other securities at depressed prices.

Take Advantage of 0% Rate Before Its Too Late. For 2008, the federal income tax rate on long-term capital gains and qualified dividends is 0% when they fall within the 10% or 15% regular federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed $65,100 if you're married and file jointly ($32,550 if you're single).

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who can. If so, consider giving them some appreciated stock or mutual fund shares, which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period is over a year.

Warning No. 1: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting investment income to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions about the Kiddie Tax.

Warning No. 2: Be aware that if you give away assets worth over $12,000 during 2008 ($13,000 in 2009) to an individual gift recipient, it will generally eat into your $1 million lifetime federal gift tax exemption and your federal estate tax exemption ($2 million for 2008; $3.5 million for 2009). However, you and your spouse can together give away up to $24,000 per recipient without any adverse effects on your respective gift and estate tax exemptions.

Ideas for Your Business

Consider Paying a Dividend in 2008. If you're a shareholder in a closely held C corporation, the current federal income tax rate structure is helpful to your cause. If the company pays you a taxable dividend, the maximum federal rate is only 15%. Better yet, as we just discussed, if the stockholder's (you or perhaps a child to whom you've given stock) taxable income is low enough there won't be any tax at all on this income assuming Kiddie Tax doesn't come into play. However, this will likely change in the near future, so now may be a good time to convert some of your C corporation wealth into cash at a very manageable tax cost (and possibly none at all). The maximum federal rate on dividends is scheduled to jump from the current 15% to a whopping 39.6% starting with 2011.

Take Advantage of Temporary Tax Breaks for Equipment and Software Purchases. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property, you might consider doing so before year-end to maximize your 2008 deductions. Here's why:

- *Bigger Section 179 Deduction.* Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2008, the maximum Section 179 deduction is a whopping $250,000. However, the allowable deduction cannot exceed your business's net income and is reduced dollar-for-dollar to the extent the amount of qualifying property placed in service during the year exceeds $800,000. For tax years beginning in 2009, the maximum deduction is estimated to drop back to about $133,000, with reductions estimated to begin when more than $530,000 of qualifying property is placed in service.

- *50% First*-year *Bonus Depreciation.* Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost (reduced by the Section 179 deduction) of most new (not used) equipment and software acquired and placed in service by December 31 of this year. The 50% first-year bonus depreciation break will expire at year-end unless Congress takes further action.

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.

Cafeteria Plan Flexible Spending Accounts (FSAs). If your company has an FSA, before year-end you must specify how much of your 2009 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 $102,000 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.

Adjusting Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2008, consider bumping up the Federal income taxes withheld from your paychecks now through the end of the year so that your total tax payments (estimated payments plus withholdings) equal at least 90% of your estimated 2008 liability or, if smaller, 100% of last year's liability (110% if your 2007 adjusted gross income exceeded $150,000, $75,000 for married individuals who filed separate returns).

Retirement Planning

Make Your 2008 IRA Contributions. Don't forget to make your 2008 traditional or Roth IRA contributions as soon as possible, but definitely before the due date (4/15/09) 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 2008.

For 2008, combined Roth and traditional IRA contributions generally can be made up to the lesser of (1) $5,000 ($6,000 if age 50 or older by the end of 2008) 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 $5,000 ($6,000 if age 50 or older by the end of 2008) 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 70_, 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 $169,000 if you're married and file jointly or $116,000 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.)

Required Distributions for Taxpayers Age 70 _ and Older. If you're age 70_ 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 70_ in 2008, you can delay your 2008 required distribution to 2009 if you choose. But, waiting until 2009 will result in two distributions in 2009—the amount required for 2008 plus the amount required for 2009. While deferring income is normally a sound tax strategy, here it results in bunching income into 2009. Thus, think twice before delaying your 2008 distribution to 2009—bunching income into 2009 might throw you into a higher tax bracket or have a detrimental impact on your tax deductions.

Don't Forget about Your Estate

The federal estate tax exemption for 2008 is $2 million. For 2009, the exemption is scheduled to increase to $3.5 million. For 2010, the federal estate tax is supposed to be repealed—but just for that one year. It now seems clear that if the promised repeal ever happens at all, it will just be for 2010. The more likely scenario is that we will continue to have a federal estate tax for 2010 and beyond with a $3.5 million or somewhat larger exemption. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan.

Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you and your spouse both can give each of them up to $12,000 this year. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So the sooner you start an annual gifting program, the better. Contact us for more information on the best ways to avoid estate taxes for someone in your situation.

Emergency Economic Stabilization Act of 2008 and Your Taxes

On October 3, 2008, the massive Emergency Economic Stabilization Act of 2008 (the Act) was signed into law. Relatively little attention has been given to the fact that the Act also includes literally hundreds of federal tax changes that will affect millions of individuals and businesses.

Personal Tax Changes —

One-year AMT "Patch" Has Two Parts. The Act includes another one-year "patch" to prevent millions of individuals from being hit with the dreaded Alternative Minimum Tax (AMT) for the 2008 tax year. As in previous years, the patch has two parts.

1. Expa*nded AMT Exemption Amounts*. Without this part of the patch, the AMT exemption amounts for 2008 would have been drastically lower than the amounts for 2007.

2. *Personal Tax Credits Can Reduce AMT Liabilities.* The second part of the patch allows you to offset your AMT amount with designated personal tax credits, which reduces the odds that you will owe the AMT for 2008.

Popular Personal Tax Breaks Are Extended by Congress. Those include:

- College *Tuition Deduction.*
- Optional *Sales Tax Deduction.*
- *Non-itemizer Deduction for Real Property Taxes.*
- *Teacher Expense Deduction.*
- *Charitable Donations from IRAs.*
- *Credits for Energy-saving Expenditures for the Home.*
- *Tax*-free *Treatment for Forgiven Mortgage Debt Extended through 2012.*

Good News If You Have Unused AMT Credits. If you generated unused AMT credits in one or more prior years (typically because you exercised some profitable incentive stock options), you may finally be able to turn those unused credits into cash. This is because the new law makes big, and very favorable, changes to the so-called refundable AMT credit rules.

New Tax-free Fringe Benefit for Bicycle Commuters. Starting next year, the Act allows employers to give a new tax-free fringe benefit to employees who commute to work on bicycles. Specifically, an employer can give tax-free reimbursements to cover amounts an employee pays to buy, improve, repair, or store a bicycle that is regularly used to commute to work.

Business Tax Changes —

15-year Depreciation Rule for Leasehold Improvements and Restaurants Extended and Expanded. The Act extends for 2008 and 2009 the favorable 15-year straight-line depreciation provision for qualified leasehold and restaurant building improvements.

New 15-year Depreciation Rule for Retail Space Improvements. Under a new provision, favorable 15-year straight-line depreciation is allowed for qualified retail improvements placed in service in 2009, but only for improvements put into use more than three years after the building itself was placed in service.

General Conclusion

With a little effort and some careful planning, it's possible your 2008 tax liability can still be reduced. We're available to assist you in this planning process any way we can. Please don't hesitate to contact us with questions or ideas regarding reducing your tax bill or planning for you business or personal finances.

Also, new this year, we have begun releasing our newsletters in email format for your convenience. Please let us know if you would prefer to receive a copy of our future newsletters via email.

Best regards,

Wittenberg CPA, PS