



An important but difficult year for tax planning

This year brings special challenges for tax planning. While the purpose of this newsletter or this Firm is not to express our political opinion with regard to either of the candidates in this election year, it is our goal to provide you with some information about the very different results that may be experienced with regard to current and future years tax laws should one or the other candidate get elected. If there is a change in the political party in the White House or a significant shift in the balance of power in Congress, it could be more important than ever to schedule a year-end tax planning meeting.

To Our Clients and Friends:

Although this year is just more than half over, we have already had three new tax laws with several more almost certainly on the way. Despite added confusion created by these repetitive changes, the current federal income tax environment is still quite favorable.

Now is the time to take advantage of the tax breaks that Congress has provided before they are taken away. This letter presents some tax planning ideas to consider this summer while you have time to think. Some of the ideas may apply to you, some to family members, and others to your business.

IRA Contribution Limits Increased

Individual Retirement Account (IRA) limits increased for 2008. The annual contribution limit is \$5,000 and if you are over 50 years of age, the limit is \$6,000. A married couple may qualify for \$10,000 or if both over 50, \$12,000. Contact us to discuss if you are qualified and if the phase-out rules will reduce your contribution limit.

Leverage Standard Deduction by Bunching Deductible Expenditures

Are your 2008 itemized deductions likely to be just under, or just over, this year's standard deduction amount? If so, consider the strategy of bunching together expenditures for itemized deduction items every other year and claim the standard deduction in the intervening years. This year, the standard deduction for married joint filers is \$10,900, for single filers it's \$5,450, and for heads of households it is \$8,000.

For example, say you're a joint filer whose only itemized deductions are \$4,000 of annual property taxes and \$7,000 of annual home mortgage interest. If you prepay your 2009 property taxes by December 31 of this year, you could claim \$15,000 of itemized deductions on your 2008 return (\$4,000 of property taxes for

this year, plus another \$4,000 for the 2009 bill, plus \$7,000 of mortgage interest). Next year, you would only have the \$7,000 of interest, but you can claim the standard deduction, which will be a little over \$11,000 after being adjusted for inflation. Following this strategy allows you to cut your taxable income by a meaningful amount over the two-year period (this year and next year). Then you can repeat the drill all over again in 2010 and 2011.

Examples of other deductible items that can be bunched together every other year to lower your taxes include the interest due with your January home mortgage payment, charitable contributions, and state income tax payments.

Watch for the Alternative Minimum Tax

While many recent tax-law changes have been helpful in reducing your regular federal income tax bill, they didn't do much to reduce the odds that you'll owe the dreaded alternative minimum tax (AMT). Therefore, it's critical to evaluate all tax planning strategies in light of the AMT rules before actually making any moves. Beware, the AMT rules are very complicated (and will probably be changed again for the 2008 tax year), you may want our assistance. We stand ready to help!

AMT and Mortgage Interest Deductions

Most people think of interest on their home equity loan or line of credit as being synonymous with deductible mortgage interest, however, this is not entirely true. In most cases, the interest on an equity loan or line of credit generates an AMT preference item which increases your alternative minimum tax.

2008 May Be a Good Year for Dividends, Stock Redemptions and Stock Sales

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%. The same 15% maximum rate applies to corporate payouts and stock sales that generate long-term capital gains. 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. Because this taxpayer-friendly scenario could change, 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). Here's why we say that.

Higher tax rates on dividends and long-term gains are scheduled to kick in starting with 2011. The maximum federal rate on dividends will jump from the current 15% to a whopping 39.6%, and the maximum rate on most long-term gains will jump from the current 15% to 20%. While 2011 may seem to be in the distant future, we could see those higher tax rates (or even worse) as early as next year—depending on how the November elections turn out. To hedge against that possibility, consider the following ideas.



- **Take Dividends in 2008.** They will be taxed at a federal rate of no more than 15%. If you wait, dividends in future years could be taxed at 39.6% (or maybe even higher) depending on how the political winds blow.
- **Do Stock Redemption Deal in 2008.** Depending on the exact circumstances, payments from your corporation to redeem (buy back) some or all of your shares will generally be treated as either taxable dividends or as proceeds from selling your shares (i.e., garden-variety stock sale treatment). Redemption payments treated as 2008 dividends will be taxed at a maximum federal rate of no more than 15%. To the extent redemption payments treated as 2008 stock sale proceeds trigger long-term capital gains, they will also be taxed at no more than 15%. If you wait, you run the risk of paying a 39.6% federal rate (or maybe even higher) on redemption payments treated as dividends and a 20% rate (or maybe even higher) on redemption payments that trigger long-term capital gains.
- **Sell Stock in 2008.** Speaking strictly from a tax-rate perspective, selling shares in 2008 and paying a federal rate of no more than 15% (for shares held over one year) beats paying a 20% rate (or maybe even higher) on gains from sales in future years.

Observation: These strategies are based on speculation about future tax rate hikes that may or may not occur. Also, there may be other more beneficial tax strategies for you and your corporation.

Contact us for more information.

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Take Advantage of 0% Rate before it's 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 (see examples below), you may have children, grandchildren, or other loved ones who will be in one of the bottom two tax brackets for 2008. 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 (before he or she sells) equals at least a year and a day. Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

The 0% rate is scheduled to be available through 2010 but things could change earlier depending on the elections. Consider taking advantage of this this year, next year could be too late. Following are several examples of the zero percent rate. See if a case approximates your facts to see if you may receive benefit this year (note: these examples ignore the effect of Alternative Minimum Tax (AMT)).

| | Case 1 Under 65 Joint | Case 2 Age 65 + Joint | Case 3 Age 65 + Joint | Case 4 Under 65 Single | Case 5 Age 65 + Single | Case 6 Age 65 + Single |
|---------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Wages (W-2) | 150,000 | | | 150,000 | | |
| Interest | 30,000 | 50,000 | 20,000 | 30,000 | 30,000 | 10,000 |
| Qualified Dividends | 30,000 | 50,000 | 20,000 | 30,000 | 30,000 | 10,000 |
| Long Term Cap Gains | 50,000 | 50,000 | 20,000 | 30,000 | 50,000 | 20,000 |
| IRA | | 50,000 | 20,000 | | 50,000 | 20,000 |
| Social Security (SS) | | 40,000 | 20,000 | | 40,000 | 20,000 |
| Total Income | 260,000 | 240,000 | 100,000 | 240,000 | 200,000 | 80,000 |
| Itemized Deductions | 64,000 | | | 66,200 | | |
| Taxable Income | 189,420 | 214,000 | 77,000 | 171,070 | 184,027 | 66,700 |
| Federal Income Tax | 32,665 | 36,448 | 8,201 | 34,698 | 35,420 | 10,168 |
| Fed Inc Tax without zero rate | 32,043 | 36,188 | 6,533 | 34,078 | 35,106 | 10,019 |
| Savings Due to Zero Rate | 622 | 260 | 1,668 | 620 | 314 | 149 |

| Scenario | Filing Status | General parameters |
|-----------------|----------------------|--|
| Case 1 | Joint | Under age 65, High W-2 & deductions, high cap gains, interest & dividends |
| Case 2 | Joint | Both age 65 or more, retirement Income, SS, high cap gains, interest & dividends |
| Case 3 | Joint | Both age 65 or more, SS, moderate cap gains, interest & dividends |
| Case 4 | Single | Under age 65, High W-2 & deductions, high cap gains, interest & dividends |
| Case 5 | Single | Over age 65 or more, retirement income, SS, high cap gains, interest & dividends |
| Case 6 | Single | Over age 65 or more, SS, moderate cap gains, interest & dividends |

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 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 without any adverse effects on your respective gift and estate tax exemptions.

Time Investment Gains and Losses

As you evaluate investments held in your taxable accounts, consider the impact of selling some appreciated securities, especially those 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. Cashing in some winners this year could turn out to be a really smart move if tax rates go up next year. Depending on how the November elections turn out, higher capital gains taxes in 2009 are a definite possibility.

Selling some loser securities (currently worth less than you paid for them) before year-end can be a good idea too. The resulting capital losses will offset capital gains from other sales this year (including short-term gains from securities owned for one year or less). If capital losses exceed capital gains, the excess losses can be used to shelter up to \$3,000 of your high-taxed ordinary income from salaries, bonuses, self-employment, and so forth (\$1,500 if you're married and file separately). However, depending on your exact situation, you could actually collect greater tax savings by triggering capital losses during a year in which you have minimal or no long-term gains. That could be next year rather than this year, especially given this year's low capital gains tax rates. Contact us if you want help in identifying your best tax-smart options.

A Word About Property Taxes

It's no secret that the real estate market has been faltering for the last several years, particularly for residential housing where the current market is significantly below the peak values achieved in 2005. What does that mean for your property taxes? You may have heard in the press or received information in the mail about having your property revalued for property tax purposes with the goal of reducing the property taxes you pay on your real estate property. Some common questions are: Are you eligible for a property tax reduction? What type of property does this apply to? Why did my property taxes go up this year when property values are falling?

First, Proposition 13, enacted into law in 1978, limits property taxes to 1% of the assessed value for a property and limits annual increases to the lesser 2% or the increase in the cost of living each year. Prop 13 applies to all real property in California whether a principal residence, vacation home, business or rental property. Prop 13 resets the "assessed value" to the purchase price of property each time the property is sold to a non-family member and typically increases property taxes by 2% per year each year thereafter. This 2% per year increase is generally automatic which is why, even in this market, your property tax bill likely rose this year over last year.

Given the falling real estate market of the last several years, you may wonder if you are eligible for a reduction in your property taxes. Generally, if you've owned your home or other property for more than 5 years, the purchase price of the property is probably still less than the value of the property today. If this is the case, then you do not qualify for a reduction in your property taxes. However, if you purchased within the last 3-4 years, the value of your property in today's market may well be below your purchase price, in this case you may be eligible for a reduction in your property taxes.

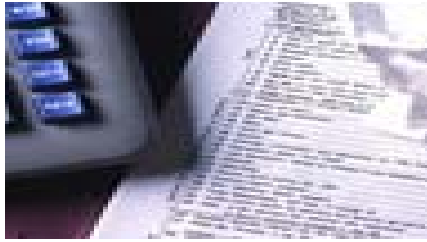
How do you obtain the reduction? You'll need to obtain a current appraisal (not just comps of recent sales in your neighborhood) and submit a request to the San Diego County Assessor's Office. You can do this yourself or there are services available to help you with the paperwork and filing of your application. Total cost will usually be \$600-\$1,000 to file your application for property tax reduction.

What's the benefit? If you establish a \$100,000 reduction in value from your current assessed value on record with the county, you could realize a savings from approximately \$1,200. Keep in mind, that this revaluation, if accepted by the county is a *temporary* reduction in the value of your property for tax purposes. Once the real estate market recovers, your taxes will readjust to the level at which you purchased your property plus two percent for each year thereafter.

Take Advantage of Generous but Temporary Tax Breaks

Several taxpayer-friendly changes kicked in this year. They include the following.

- **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. For tax years beginning in 2009, however, the maximum deduction is scheduled to drop back to about \$130,000 (depending on the inflation adjustment). Various limitations apply to the Section 179 deduction privilege, so please contact us if you want more information.
- **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 of new (not used) equipment and software acquired and placed in service by December 31 of this year. Certain leasehold improvements qualify for this provision. The 50% first-year bonus depreciation break will expire at year-end unless Congress takes further action. Contact us if you want more details about this generous, but temporary, tax break.
- **Qualified Conservation Donations.** Congress just extended rules that allow extra-favorable tax treatment for qualified conservation contributions by individuals and farm businesses to charitable organizations. These rules are now available for contributions in tax years beginning 2008 and 2009.
- **Economic Stimulus Rebates.** The government has already issued economic stimulus rebate payments to millions of individuals. The payments can range from \$300 to \$1,200 or more for those with children. Rebate amounts are based on information reported on your 2007 individual federal income tax return. You (or a loved one) may qualify for a rebate even though you are not required to file a 2007 return because you had only a modest amount of income last year. However, anyone who wants to collect a rebate in 2008 must file a 2007 Form 1040 or Form 1040A. No return, no rebate, no exceptions! Contact us if you have questions about filing a return to collect a rebate.



Consider Deferring Income

It may also pay to defer taxable income from this year to next year, especially if you expect to be in a lower tax bracket in 2009. 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 some deductible business expenses before the end of this year. Both moves will defer taxable income from this year until next year.

Deferring income may also be helpful if you're affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (such as itemized deductions, the child tax credit, the education tax credits, and so forth). By deferring income every other year, you may be able to substantially increase your eligibility for these tax breaks every other year.

Caveat: Depending on the outcome of the November elections, high-income taxpayers (those with taxable incomes exceeding around \$250,000) stand a good chance of seeing higher regular income tax rates in 2009. If that becomes the case, it may pay to accelerate income from 2009 into 2008.

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 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, but possibly (hopefully) with a somewhat larger exemption than the current \$2 million figure. 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 can give each of them up to \$12,000 this year. So can your spouse. 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.

Conclusion

As we said at the beginning, this letter is intended to give you just a few ideas to get you thinking about tax planning for 2008.

Please don't hesitate to contact us if you want more details or would like to schedule a tax planning strategy session.

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Congressional Action Required

Several issues require congressional action, and are needed this summer. Both parties have agreed to a one-year AMT fix, the issue offsetting the reduced revenue. The Democrats have proposed an increase in tax on a very limited number of taxpayers who have created an income structure that taxes all their income as capital gain, and the increase would make this income taxed as ordinary income and subject to Social Security and Medicare Taxes that the rest of us pay. Republicans do not want to increase taxes period.

The other issue affecting a number of clients is the ability to have all or a portion of your Required Minimum Distribution for your IRAs paid directly to charities. Congress gave us this option for the years 2006 and 2007. There is proposed legislation to extend it to 2008, but unless the bill is passed and signed this Summer, it will be too late to benefit anyone.

We will be monitoring these issues and suggest that you delay taking your IRA distribution if you want to use the charitable option.

Auto Mileage Rates Changed

The Internal Revenue Service has increased the optional standard mileage rates for the final six months of 2008. Taxpayers may use the optional standard rates to calculate the deductible costs of operating an automobile for business, charitable, medical or moving purposes.

The rate will increase to 58.5 cents a mile for all business miles driven from July 1, 2008, through December 31, 2008. This is an increase of eight (8) cents from the 50.5 cent rate in effect for the first six months of 2008.

The new six-month rate for computing deductible medical or moving expenses will also increase by eight (8) cents to 27 cents a mile, up from 19 cents for the first six months of 2008. The rate for providing services for charitable organizations is set by statute, not the IRS, and remains at 14 cents a mile.

Filing Deadline Change for 2008

Currently partnerships and trusts that obtain an extension time to file returns have until October 15 to file their return. This has created problems for the individuals who are partners in these partnerships and/or beneficiaries of these trusts, as a portion of the income and deductions reported by these entities must be included on the individual returns, which are also due October 15. Sometimes, our clients do not receive the income form (Schedule K-1) until October, which creates a last minute scramble to complete the individual returns.

The IRS has recognized this problem and is changing the extended due date for partnership and trust returns to September 15 starting with the 2008 tax year. So 2008 partnership and trust tax returns will be due September 15, 2009, which will result in the income information for individuals being available up to one month earlier. First the increase in mileage rate, then the change in due dates. Two logical and efficient changes from the IRS!